IN THE

Supreme Court of the United States

OCTOBER TERM 1922

Brush Electric Company, Appellant,
vs.
City of Galveston et al., Appellee
No. 179

On Appeal From The District Court Of The United States, For The Southern District Of Texas, Galveston Division.

BRIEF FOR APPELLANT

This case is here on appeal from a decree overruling certain exceptions of the complainant, (appellant), to the report of the Special Master appointed in the case, and dissolving the temporary restraining order granted in said cause, and denying the injunction prayed for by complainant, and dismissing the bill filed in this case, without prejudice.

STATEMENT OF THE CASE

PLEADINGS

The bill alleges that plaintiff is a corporation, organized under the laws of the state of Delaware; and that the defendants are the city of Galveston, a municipal corporation, and certain named officials composing the Board of Commissioners of said city.

It alleges the necessary jurisdictional facts. It then alleges:

That the plaintiff's predecessor, Brush Electric Light and Power Company, was granted two franchises by the city of Galveston, authorizing the construction and maintenance of an electric light and power plant. Neither of said franchises embodied a contract respecting the charges, but reserved to the municipality the right to regulate the charges.

That on March 23rd, 1911, the municipal authorities adopted an ordinance consenting to the transfer from the Brush Electric Light and Power Company, to the appellant, of the franchises hereinbefore referred to. The two companies had built up an extensive electric light and power business, and operated an efficient plant for that purpose.

That prior to March 25th, 1915, the municipal authorities had never undertaken to regulate the charges of the plaintiff or its predecessor, but on that date adopted an ordinance for that purpose, which is set out in the bill; and that the plaintiff complied to the terms of that ordinance.

The bill then sets out the value of plaintiff's

plant in 1915, and the gross earnings, operating expenses, and net revenue derived by the plaintiff under the ordinance of March, 1915, for the years 1915, 1916 and 1917.

It then alleges that in July, 1918, in view of the increased cost of operation of complainant's plant, plaintiff appealed to the Board of Commissioners, for an increase of rates; and on the eighteenth day of July, 1918, the Board of Commissioners adopted an ordinance, set out in the bill, which provided for rates higher than those fixed in the 1915 ordinance, which ordinance was accepted by plaintiff.

On July 31st, 1919, the Board of Commissioners of the city of Galveston adopted an ordinance, decreasing the maximum rates to be charged by the plaintiff, which ordinance is set out in the bill.

The bill then goes on to set up the value of plaintiff's plant, the gross earnings, which it is estimated the plaintiff would have received under the rates fixed by the ordinance of July 31st, 1919, and the operating expenses; and charges that both the 1918 and 1919 ordinances fixed rates so low, as to prevent the complainant from earning a fair return on the reasonable value of its property, used and usable in the public service. It alleges that a fair return, under the circumstances, is ten per cent (10%) per annum on the value of the properties of the plaintiff, that rate being provided by Article 1018 of the Revised Civil Statutes of Texas, of 1911.

The bill prayed for a temporary restraining order against the defendants, to prevent them from enforcing or attempting to enforce each and

every one of said ordinances, and particularly the 1919 ordinance, and from enforcing the penalties prescribed in said ordinance, and prayed that a temporary injunction be granted to the same effect, and that upon a final hearing, the said injunction be made perpetual.

The answer of the defendant in substance admitted the formal allegations of the bill of complaint, but denied the confiscatory nature of both of said ordinances, and all of the facts alleged in the bill, upon which the charge of confiscation was predicated.

The bill of complaint was filed August 21st, 1919; and was later amended in certain particulars not deemed necessary to set out in this brief.

On August 20th, 1919, District Judge Hutcheson being absent from the district, and from the Fifth Circuit, Circuit Judge Batts, of Austin, Texas, ordered the issuance of the temporary restraining order applied for, to remain in effect until the fourth of September, 1919. (See printed record page 44.)

On August 22nd, 1919, a stipulation was entered into by the parties, whereby the clerk of the District Court was directed to issue the restraining order provided for in the order entered by Judge Batts, on the 20th of August, and by the terms of said stipulation, it was agreed that the restraining order should remain in effect until the application for a temporary injunction was heard and passed upon; and that in the meantime the ordinance of July 31st, 1919 should remain wholly

unenforced and unenforceable. (Printed record page 46.)

This stipulation was approved by Circuit Judge Batts, and filed August 25th, 1919.

Thereupon the Clerk issued the restraining order.

On June 28th, 1920, Judge Hutcheson entered an order appointing Lewis R. Bryan Special Master, to hear and take evidence in the case, and make his report as to the facts and his recommendations in the premises to the court for its further action.

The hearing of evidence before the Master was commenced August 26th, 1920, and continued until September 30th, 1920.

On October 12th, 1920, the Master filed his report as to the value of the plaintiff's property, the rate of return and rate of depreciation, the past earnings of the Company, and the earnings which would be obtained under the proposed ordinance, if enforced, and concluded his report with the finding that the ordinance of 1919 was confiscatory, but that the ordinance of 1918 was not confiscatory.

To this report, the defendant filed sixteen (16) exceptions, all of which were sustained by the District Judge, except two (2).

The complainant filed seven (7) exceptions, all of which were, by the District Judge, over-ruled.

Thereupon the Court, by decree, dissolved the temporary restraining order, refused to grant the temporary and permanent injunction prayed for, and dismissed the bill without prejudice.

From this decree this appeal is prosecuted.

EVIDENCE

It is deemed more convenient to briefly abstract the evidence with reference to each contention insisted upon, under the separate propositions thereby raised.

However, there are certain general facts to which it would seem proper to call attention, at the beginning of this brief.

The Master found that the ordinance of 1918 was not confiscatory, and his finding in this respect was not attacked by any exception of the defendants, so that the validity of the ordinance of 1918 is not now involved in this case.

The ordinance of July 18th, 1918 was adopted by the municipal authorities of Galveston, in response to an application of the complainant for an increase in rates, and after a full hearing. An election was held for members of the Board of Commissioners of the city of Galveston, May 13th, 1919, ten months after the adoption of the 1918 ordinance. At this election, all the members of the Board of Commissioners who adopted the rate ordinance of 1918 were candidates for re-election. They were opposed by candidates of what was known as the city party.

During the campaign preceding the election of 1919, the rate for electric current, as fixed by ordinance of 1918, was one of the campaign issues, and the rates prescribed by that ordinance were attacked by candidates of the city party, one plank of whose platform was:

> "No raising of gas and electric rates and street car fares, without the consent of the people."

In the election held May 13th, 1919, all members of the old Board which adopted the ordinance of 1918 increasing electric light rates, were, of course, defeated, and the candidates of the city party, who by their platform promised to reduce rates were, of course, elected.

They qualified on the 22nd day of May, 1919. Fifty-six days after they qualified and on July 18, 1919, a notice was issued by the city secretary on the order of the newly elected Board of Commissioners, directed to the complainant, commanding them to appear on July 30th, 1919, to show cause why the rates for electric current should not be reduced. (See testimony of A. D. Cavin, page 249.)

The notice referred to appears in full, page 249 of the printed record.

On July 30th, 1919, the manager for complainant (appellant) submitted to the municipal authorities a statement which was introduced in evidence, page 36, Exhibit 16, part one, which Exhibit has been certified to this Court.

On the very next day, July 31st, 1919, the newly elected Commissioners adopted the ordinance which is the subject of attack in this litigation, and which by its terms was to take effect immediately.

There is no evidence in the record that up to that time, the city had made any attempt to value the complainant's plant, or that it had made any investigation whatever as to the value of the plant or the earnings of the Company up to that time,

or as to the probable revenue to be derived under the proposed ordinance.

Mr. Elrod, the city's expert witness, was employed by the city of Galveston to make an investigation and appraisal of the property of the Brush Electric Company, and commenced that employment March 12th, 1920, nearly eight months after the ordinance of 1919 was adopted. He was engaged about two and a half months in making his investigation and appraisal.

It would appear therefore, that the ordinance of July, 1919, was not adopted after investigation or hearing, but that it was adopted in response to a popular demand, and to carry out an ante-election pledge made by candidates for political office, in order to secure election.

At the hearing before the Master, there was introduced in evidence an agreement between the parties, as to the value of the "bare bones" of the property, which agreement differentiates this case from many other rate cases, and which appears on page 50 of the printed record.

The Master, after hearing the evidence and personally inspecting the property, made his report, adopting as the undepreciated value of the bare physical property that sum which was agreed to as its cost at present prices, undepreciated, as of January 1st, 1920.

From this sum, he deducted the value of the real estate and office and utility equipment, and adopted the remainder as the undepreciated value of the depreciable items. He reported that the depreciated value was 72% of the undepreciated

value of these items, and then added certain intangibles, and the value of non-depreciable property He reported that the fair value of all the property in its present condition was eight hundred thousand dollars ($800,000.00.)

He recommended 8% for annual return, and 4½% for depreciation.

He reported as to the gross earnings, operating expenses, maintenance and net earnings, for the year ending July 31st, 1920. Certain of the operating expenses the defendant objected to before the Master. The Master over-ruled the defendant's objection.

The defendants' exceptions to the Master's report attacked the Master's finding as to undepreciated valuation of the "bare bones", the amount of accrued depreciation deducted therefrom by the Master, and the amount allowed by the Master for each item of intangibles, as well as the rate of annual depreciation allowed, and the items of expense allowed by the Master, to which defendants had objected, but the defendants did not except to the Master's findings as to what the plaintiff's gross revenue would have been or would be under the 1919 ordinance if enforced.

The plaintiff's exceptions to the Master's report attacked the Master's finding as to the amount of accrued depreciation, and the Master's finding of value, (because of a perfectly apparent error in mathematical computation), and the amount allowed by the Master for interest during construction, rate of return, and annual depreciation allowed by him, and also because the Master

did not allow anything for taxes during construction, or for preliminary operations and adaptation.

The court sustained all of the defendant's exceptions, except two: the sixth, which he over-ruled, and allowed a certain sum for working capital; and the tenth, which attacked the items of gratuitous service on customers' premises.

The court over-ruled all of plaintiff's exceptions to the Master's report.

SPECIFICATIONS OF ERRORS RELIED UPON

I.

The court should have definitely adopted as the present undepreciated value of the "bare bones" of plaintiff's physical property, the value agreed upon by the parties, as of January 1st, 1920, to-wit, $784,689.00, which value was adopted by the Master; and should have over-ruled defendants' first exception to the Master's report.

See first assignment of errors, printed record, page 63.

Authorities relied upon:

Galveston Electric Co., vs. Galveston, 272 Fed., 147;
Galveston Electric Co. vs. Galveston,------ U. S.,------;
Smyth vs. Ames, 169 U. S., 466;
San Diego Land and Town Co. vs. National City, 174 U. S., 739;

Ames vs. Union Pacific, 64 Fed., 165;
Cotting vs. Godard—Kansas City Stock Yard, 183 U. S., 79; 46 L. Ed., 92;
San Diego Land and Town Co. vs. Jasper, 189 U. S., 439;
Stanislaus vs. San Joaquin C. & I. Co., 192 U. S., 201;
San Joaquin C. & I. Co. vs. Stanislaus, 113 Fed., 930;
Knoxville vs. Knoxville Water Co., 212 U. S., 1;
Consolidated Gas Co., vs. City of New York, 157 Fed., 849;
Wilcox vs. Consolidated Gas Co., 53 L. Ed., 382;
Simpson vs. Shepard, (Minnesota Rate case) 230 U. S., 352;
Shepard vs. Northern Pac. Ry., 184 Fed., 765;
Des Moines Gas. Co. vs. Des Moines, 238, U. S., 153;
Denver vs. Denver Union Water Company, 246 U. S., 178;
Lincoln Gas & Electric Company vs. Lincoln, 223 U. S., 349;
Lincoln Gas & Electric Company vs. Lincoln, 250 U. S., 256; 63 L. Ed., 968;
Lincoln Gas & Electric Company vs. Lincoln, 182 Fed., 926;
Whitten's Valuation of Public Service Corporations, page 69, section 72;
Hayes' Public Utilities, pages 18 and 217;
Floyd's Valuation of Public Utilities, page 18;
Consolidated Gas Company of New York vs. Newton, 267 Fed., 236;
Newton vs. Consolidated Gas Company, ------U. S.------Advance Opinions April 15th, 1922, page 305;

Elizabethtown Gas Light Co. vs. Board of Public Utility Commissioners, 95 New Jersey Laws, page 18, 111 Atlantic, 729;
St. Joseph Light, Heat & Power Co. vs. Public Service Commission, 268 Fed., 267;
Joplin & Pac. Ry Company, 267 Fed., 587;
Landon vs. Court of Industrial Relations, 269 Fed., 443;
National Waterworks Co. vs. Kansas City, 62 Fed., 865;
Matthews vs. Board of Corporation Commissioners, 106 Fed., 9;
Cumberland T. & T. Co. vs. Louisville, 187 Fed., 642;
Des Moines Water Co. vs. Des Moines, 192 Fed., 196;
L. & N. R. R. Co. vs. Railroad Commission, 196 Fed., 820;
Spring Valley Water Co. vs. San Francisco, 252 Fed., 989;
People vs. Wilcox (N. Y. Court of Appeals), 104 N. E., 915;
Murray vs. Public Utilities Commission, (Idaho Supreme Court), 150 Pac. Rep., 50;
State P. U. C. ex rel. Springfield vs. Springfield G. & E. Co. (Ill. Supreme Court) P. U. R. 1920 C, 664-665.

II.

The court should have fixed the accrued depreciation of plaintiff's physical property at $207,984.84, being 28% of the agreed undepreciated value of the depreciable items, included in the agreed valuation of the "bare bones"; and should have over-ruled defendants' second exception to

the report of the Master, and should have sustained complainant's fifteenth and sixteenth exceptions to the Master's report.

See second assignment of errors, printed record, page 64.

See fifteenth assignment of errors, printed record page 67.

See sixteenth assignment of errors, printed record page 68.

Authorities relied upon:

Des Moines vs. Des Moines, 238 U. S., 153; Winona vs. Wisconsin, 276 Fed., 1004.

III.

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, as did the Master, for contractors' expense and profit, 10% of the depreciated value of the depreciable items of physical property, included in the agreed valuation or the sum of $53, 481.00; and should have overruled defendants' third exception to the report of the Master.

See third assignment of errors, printed record page 64.

IV.

The court, in arriving at the total present depreciated value of plaintiff's property should have allowed and included therein, as did the Master, for engineering and supervision, $26,740.00, being 5% of the depreciated value of the items of depreciable physical property, included in the

agreed valuation and should have over-ruled defendants' fourth exception to the Master's report.

See fourth assignment of errors, printed record page 64,

V.

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, as did the Master, for omissions and contingencies, $10,696.00, being 2% of the depreciated value of the items of depreciable physical property included in the agreed valuation; and should have over-ruled defendants' fifth exception to the report of the Master.

See fifth assignment of errors, printed record page 64.

VI.

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein for interest during construction $21,392.00, being 4% of the depreciated value of the items of depreciable physical property included in the agreed valuation; and should have sustained plaintiff's third exception to the Master's report.

See seventeenth assignment of errors, printed record page 68.

VII.

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, for taxes during construction, the sum of $5,348.00; and should have

sustained plaintiff's fourth exception to the Master's report.

See eighteenth assignment of errors, printed record page 68.

VIII.

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, as did the Master, for "Going Value," at least the sum of $46,195.00; and should have over-ruled defendants' seventh exception to the Master's report.

See sixth assignment of errors, printed record page 65.

Authorities relied upon:

Galveston Electric Co. vs. Galveston, 272 Fed., 147;
Galveston Electric Co. vs. Galveston,---- U. S.,------, May 15th L. C. O. Advance Opinions, page 382.
Des Moines Gas. Co. vs. Des Moines, 238 U. S., 153, 59 L. Ed., 1244;
Cedar Rapids Gas Light Co. vs. Cedar Rapids, 223 U. S., 655, 56 L. Ed., 594;
Denver vs. Denver Union Water Co., 246 U. S., 178, 62 L. Ed., 649;
Lincoln Gas. & Electric Co. vs. Lincoln, 250 U. S., 256, 63 L. Ed., 968;

IX.

The court should have fixed the "rate base" or present fair depreciated value of all plaintiff's property as a going concern, at $825,230.00; and should have over-ruled defendant's eighth exception to the Master's report.

See seventh assignment of errors, printed record page 65.

See twenty-second assignment of errors, printed record page 69.

See twenty-third assignment of errors printed record page 69.

See twenty-fourth assignment of errors, printed record page 70.

See twenty-fifth assignment of errors, printed record page 69.

See twenty-sixth assignment of errors, printed record page 71.

See twenty-seventh assignment of errors, printed record page 71.

See twenty-eighth assignment of errors, printed record page 71.

X.

The court should have found that the plaintiff Company is entitled to an annual depreciation allowance of $40,605.57, being 4½% of the undepreciated reproduction value of its used and usable physical property, complete and in operation, such undepreciated reproduction value being made up of the agreed value of the "bare bones," plus contractors' expense and profit, engineering and supervision, omissions and contingencies and interest and taxes during construction; and should have over-ruled defendant's ninth exception to the Master's report, and should have sustained plaintiff's seventh exception to said report.

See eighth assignment of errors, printed record page 66.

See twenty-first assignment of errors, printed record page 69.

Authorities relied upon:

Knoxville Water Co. vs. Knoxville, 212 U. S., 1;
Cumberland T. & T. Co. vs. City of Louisville, 187 Fed., 652 and 653.

XI.

The district court should have held that plaintiff Company is entitled to earn, as a fair return, at least ten percentum per annum on the present fair "going value" of all its property; a return of ten percent being prescribed by Article 1018 of the Revised Statutes of Texas, 1911.

See twentieth assignment of errors, page 69 of the printed record.

Authorities relied upon:

Article 1018 Revised Statutes, 1911, State of Texas;
Article 1028 Revised Statutes, 1911, State of Texas;
Wilcox vs. Consolidated Gas Co. 212 U. S., 19, (on page 48), 53 L. Ed., 398;
Denver vs. Denver Union Water Co., 246 U. S., 178, (on page 194);
Lincoln Gas Co. vs. Lincoln, 250 U. S., 256, (on page 268.)

XII.

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the district court should have

allowed, as did the Master, the sum of $2320.37 for travelling expense, as a reasonable and proper item of expense; and should have over-ruled defendants' eleventh exception to the Master's report.

See ninth assignment of errors, page 66 of the printed record.

XIII.

In determining the amount of net earnings which would be produced under the 1919 ordinance if enforced, the district court should have allowed, as did the Master, the sum of $14,024.27 for new business expense, as a reasonable and proper item of expense; and should have over-ruled defendants' twelfth exception to the Master's report.

See tenth assignment of errors, printed record page 66.

XIV

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the district court should have allowed, as did the Master, the sum of $2,200.21 for storm expense, and the sum of $6,379.99 for fire expense, as reasonable and proper items; and should have over-ruled defendants' thirteenth exception to the Master's report.

See eleventh assignment of errors, printed record page 66.

XV.

In determining the amount of net earnings

which would be produced under the 1919 ordinance, if enforced, the district court should have allowed, as did the Master, the sum of $47,534.29, for maintenance expense; and should have overruled defendants' sixteenth exception to the Master's report.

See fourteenth assignment of errors, printed record page 67.

XVI.

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the District Court should have allowed, as did the Master, the sum of $750.56 for condemned meters, and $75.03 for condemned transformers; and should have over-ruled defendants' fifteenth exception to the Master's report.

See thirteenth assignment of errors, printed record, page 67.

XVII.

The enforcement of the ordinance of 1919 should have been enjoined without requiring plaintiff Company to make any actual test of the rates therein prescribed, because:

(a) The defendants, in the district court ,in effect, waived such a test and urged the court below to pass upon the constitutionality of the ordinance, without requiring such test;

(b) The defendants did not except to the finding of the Master, as to the amount of gross revenue which would be derived by plaintiff Company,

under the rates prescribed by the 1919 ordinance, if enforced;

(c) Said ordinance of 1919 was adopted by the Board of Commissioners of the city of Galveston, without any valuation of complainant's property, or any investigation, examination or audit of its business, properties, earnings or expenses, but on the contrary was adopted by a newly elected Board of Commissioners, who, during a political campaign, in order to secure their own election promised to reduce electric rates, and immediately after taking office, adopted said ordinance, without consideration or investigation, in order to carry out their pre-election promises;

(d) The evidence and the report of the Master show that the rates prescribed by the 1919 ordinance, if enforced, would be clearly confiscatory.

This proposition is covered by assignment of errors, numbers twenty-two, twenty-three, twenty-four, twenty-five, twenty-six, twenty-seven and twenty-eight.

Authorities relied upon:

Knoxville vs. Knoxville Water Co., 212 U. S., 1, 53 L. Ed., 371.

Ames vs. Union Pacific, 64 Fed., 165;

Smyth vs. Ames, 169 U. S., 466;

Seaboard Airline vs. Railroad Commission, 155 Fed., 792;

Georgia vs. Railroad Commission, 161 Fed., 925.

FIRST PROPOSITION

The court should have definitely adopted as the present undepreciated value of the bare bones of plaintiff's physical property the value agreed upon by the parties as of January 1, 1920, to wit, $784,689.00, which value was adopted by the Master. Assignment of error number one. (Printed Record, p. 63.)

The Master's report, printed record page 50, states:

> "At the beginning there was filed an **agreement by the parties** covering what was called the 'bare bones' **valuation** of the properties, reading as follows:
>
> 'We * * * agree to the following valuations of said properties:
>
> Cost of bare physical property **at present prices,** undepreciated as of January 1st, 1920, seven hundred eighty-four thousand six hundred eighty-nine dollars ($784,689.00);
>
> Cost of bare physical property **at average pre-war prices,** undepreciated as of January 1st, 1920, five hundred seventy-six thousand eight hundred ninety-eight dollars
> ----------$576,898.00.
>
> It is understood that the above figures cover only the 'bare bones' of the properties, and do not include the following intangible, and other values:

Contractor's expense and profit;
Omissions and contingencies;
Engineering and supervision;
Organization and legal expense;
Taxes during construction;
Working capital;
Interest during construction;
Materials and supplies;
Going value.' "

This, then, was a definite agreement, binding upon both parties, and upon the Master, the District Court and this Court, as to the undepreciated value of the physical properties based:

(a) Upon present prices;
(b) Upon average pre-war prices;

and also as to what items of value, i. e. intangibles, were not taken into consideration in arriving at these respective valuations.

This agreement left open to the court, in arriving at the undepreciated "bare bones" value of the physical property, only one question, i. e., **which** of the **two** valuations should the court **as a matter of law,** adopt. This agreement eliminated from consideration:

(a) Any question as to conflict in inventories of property;
(b) Any question as to whether any item of property embraced in the inventories was used or useful in the public service;
(c) Any question of historical cost, conflicting opinion testimony as to values, appreciation over original cost, amount of stock and bonds outstanding, etc.

This agreement put up to the lower court and to this court, on appeal, one question, and only one question, with respect to the value of the "bare bones", viz: "where the items of physical property are agreed upon, and their use and usefulness in the public service is not controverted, should the court in testing the constitutionality of a rate prescribed in August, 1919, arrive at the undepreciated value of such property,

> (a) By applying agreed average prices prevailing during the period of five (5) years next prior to 1916, that is to say, from 1912 to 1916 inclusive; or
> (b) By applying the prices prevailing **at the time when the property was being used,** and at the time when the ordinance would, by its terms, be effective, and at the time when its confiscatory nature was being asserted and its constitutionality attacked."

The Master (and we think properly) found that, under the decisions of this court, he was bound, in arriving at the present valuation of the "bare bones" for the purposes of this case, to adopt present prices, and therefore, under the agreement, fixed the present undepreciated value of the "bare bones" at the agreed sum of seven hundred eighty-four thousand six hundred eighty-nine dollars ($784,689.00.)

Defendant's exception number one challenged this finding, and insisted that the Master should have adopted average pre-war prices, and upon that basis, should have fixed the undepreciated value of the "bare bones" as five hundred seventy-six thousand eight hundred ninety-eight dollars ($576,898.00.)

The court sustained defendant's exception, thereby judicially determining that the Master was wrong, and inferentially at least, that the defendant was right.

In his opinion, the learned District Judge says, record page 371, (printed record page 294):

> "I shall therefore sustain the first exception of the defendants. Having done so, I shall not substitute a **value of my own,** for the reason that in view of the fact that the injunction will be denied on the ground that the ordinance has had no test, and that, in my view, taking the Master's base, the ordinance is still not confiscatory, it will not be necessary for me **to hazard a guess** as to what value ought to be taken, since I feel sure that before the precise valuation of the plant by me can become important, conditions of prices and values will have settled down to such a definite and permanent basis, as that there will be no difficulty in reaching a proper price basis to apply on any future adjustment in or out of court."

We submit that, under the agreement referred to above, the court was without right to "substitute a value of my own" or "hazard a guess as to what value ought to be taken."

The learned District Judge, as indicative of what his valuation would be, refers to his own views expressed in his opinion in the case of Galveston Electric Company vs. City of Galveston 272 Federal Reporter, page 147, affirmed by this court April 10, 1922,_____U. S. Reports page _____ _____L. Ed. page_____.

We respectfully submit that the reference to the

Galveston Electric case is not apposite. In the Galveston Electric case, there was no such agreement in the record, as in this case, and the court below was left in the Galveston Electric case to ascertain the present value, by taking the **historical cost** and adding some arbitrary percentage (the court adopting thirty three and one-third percent, (33 1-3%) to cover appreciation due to increased prices.

Therefore, in that case, the court was possibly authorized to "substitute a value of my own" or "hazard a guess as to what value ought to be taken"; but the situation in this case is different, where the parties have agreed upon values based upon two different standards, and have left the court only to choose which standard, **under the law,** it should apply.

On page 378 of the record (printed record page 298), the court says,

> "While I will assume for the purpose of testing the 1919 ordinance, in the light of its estimated but not actual results, the base value taken by the Master **I sustain the exception** to that finding, and am not actually adopting that value."

It is perfectly apparent therefore, that although the court did not substitute any value of his own, he did sustain the exception to, and set aside, and did not adopt the valuation reported by the Master, which valuation we insist should have been definitely adopted, and the exception over-ruled.

The action of the court below in not definitely fixing any valuation, and in refusing the injunction, and in dissolving the temporary restraining

order, appears from the opinion, to have been based upon the following grounds:

> (a) Because the Master found that under the rates authorized by the Ordinance of 1918, the company had earned a return of four thousand dollars ($4,000.00) in excess of eight percent (8%) of the value of its property.
>
> (b) Because the rates prescribed by the Ordinance of 1919 had not been actually tested.
>
> (c) Because the values as of January first, 1920 were not static, but were in a process of flux, and the price levels as of that date were of a transitory character.

We respectfully submit that none of these propositions should have been given any weight by the court in arriving at its conclusions, for the following reasons:

(a) **Past Earnings.** The Master found, page 70 of the record, (printed record pages 53-54), that for the year ending July 31st, 1920, the company was entitled to earn a revenue of one hundred thousand dollars ($100,000.00), being four and one-half percent (4½%) for depreciation, and eight percent (8%) per annum return on an eight hundred thousand dollar ($800,000.00) valuation; and that under the rates prescribed by the Ordinance of 1918, the company earned one hundred four thousand, four hundred fifty-seven and ninety-two one-hundredths dollars ($104,457.92), or four thousand four hundred fifty-seven and ninety-two one-hundredths dollars ($4,457.92) in excess of what the Master reported to be a fair return. This return is only 9½% on the value of the property as found

by the Master or one-half of one per cent **less** than the 10% return provided for in Article 1018 Revised Civil Statutes of Texas, 1911.

It appears from the decisions of the courts, that the courts will not, in determining the confiscatory nature of a prescribed rate, take into consideration past losses, and the courts, in order to be fair, will likewise apply a rule that, in determining whether a proposed rate is confiscatory, they will not take into consideration the fact that, under an ordinance (one year older) which would be effective, if the operation of the new ordinance is enjoined, the company actually did earn 9½% on the fair value of its property. As was said by the court in Newton vs. Consolidated Gas Co.____U. S.____ decided March 6, 1922, "Mere past success could not support a demand that it continue to operate indefinitely at a loss."

This court will certainly not lay down the rule that in no case must a company earn more than eight percent (8%), on the depreciated value of its property, and that when it appears that it is earning more than that amount, it will refuse to enjoin the operation of a new ordinance which would be confiscatory if enforced.

The effect of such a ruling would be to say to the holders of capital, considering investment in public utilities: "You cannot, under any circumstances, earn more than eight percent (8%) upon the depreciated value of your property; if, by reason of unfortunate business conditions, you earn less than that amount, that is your misfortune. The only protection the courts will give your investment is, if rates are prescribed, which

by actual test, prevent you from earning a fair return, we will enjoin the operation of the rates, provided you have not, in the past, earned more than eight percent (8%); but if you have, in the past, earned more than eight percent (8%), we will not enjoin the enforcement of rates which will prevent you from earning as much as eight percent (8%); on the other hand, if you earn at any time less than eight percent (8%), we will not take that into consideration, in considering the confiscatory nature of a proposed new rate, and allow you to make up such deficit by enjoining the enforcement of the new rate, until the loss has been replaced, nor will we permit you to capitalize past losses. You can never earn more than eight percent (8%) and you may earn much less."

If such a rule were adopted, no additional private capital would be invested in public utilities; money at present invested in public utilities might remain, because there would be no way of withdrawing it, but no provision could be made for public utility extensions made necessary by the growth of the community. Certainly government construction and operation at least of additional facilities would be inevitable.

Capital can not be attracted by the prospect of possible loss, and the certainty that, in no event, could the gain be much in excess of rates of interest which can be obtained upon securities affording much less, if any, prospect of loss of the capital.

It is the possibility and the hope that the rate of gain **may** be in excess of interest rates obtainable with little or no prospect of loss that induces

capital to invest in such hazardous enterprises as public utilities.

(b) **No Test.** On page 371 of the record (printed record page 294) the court below assigns two reasons for not definitely deciding the question of value of the property, one of these reasons being:

> "In view of the fact that the injunction will be denied on the grounds that the ordinance has had no test, * * "

We are not unmindful of the fact that the courts in many cases have, when the point has been raised **and insisted upon** by the rate-making body, declined to enjoin the operation of a certain rate, until a test thereof has been made.

On the other hand, in numerous cases, the courts have enjoined the operation of a rate clearly confiscatory, without requiring a test.

In the present case, it appears from the record, that the defendants did not insist upon, but on the other hand, in effect, waived a test.

It is true that paragraph XVII of the answer of defendant states that the plaintiff failed and refused to put said rates into effect and is therefore estopped from denying that the same are unreasonable and unjust and if put into effect would yield a fair return; but we insist that in the progress of the case defendants waived this contention.

The Master, on page 70 of the record, (printed record page 53), finds and reports what the gross revenue of the company would have been from August 1st, 1919 to July 31st, 1920, if the rates prescribed by the ordinance of July 1919 had been put in effect. Although the defendant filed six-

teen (16) exceptions to the Master's report, there is no exception which challenges the Master's finding as to what the gross revenue would have been under the 1919 ordinance.

It appears from the record that it was the evident desire of both parties to the cause, to have the questions presented by the record determined without waiting for a test.

The court below, in its opinion, appears to recognize the fact that the proposition of making an actual test of the rates is not insisted upon by the city, and that both parties desired that the other questions in the case be settled, because he says, printed record page 293.

> "In this case, however, since the record shows that the circuit judge had granted the temporary restraining order, set the matter down for speedy hearing, and that the city has, by agreement, permitted the temporary restraining order to continue in force, without seeking relief against it, and in view of the further fact that **both parties have not only acquiesced in, but have apparently desired that the matter be presented to and passed on by the court, notwithstanding the fact that the ordinance has not had a trial,** I shall pass upon the the exceptions to the Master's report."

We therefore insist that the fact that the rates prescribed in this ordinance have not been put to an actual test should not have influenced the court below, and should not influence this court, and in the consideration and for the purposes of this case, all parties and the court are bound by the finding of the Master, that the rates prescribed by the or-

dinance of 1919 would have produced, had they been put into operation, a gross revenue of two hundred seventy-seven thousand, two hundred sixty-seven and thirty-nine one-hundredths dollars ($277,267.39) for the twelve month period ending July 31st, 1920.

(c) **Present Values Not Static.** The fact that the prices and values were not static on January first, 1920 does not relieve the court of the duty of arriving at the value of the property, as of that date, nor should it be taken into consideration in determining what the value of the property was on January first, 1920. Prices and values, in their very nature of same are not static.

We submit that the testimony as to past values and prophecies as to probable future values should have no weight in determining what the value of the property is, as of any given date.

The proposed ordinance was by its terms effective, from the date of its passage, July 31st, 1919. It was to remain in effect until it was repealed or amended. It was subject to repeal or amendment at any time within a month or a year or two years. It in effect repealed an ordinance adopted July 15th, 1918, which in turn superceded the rates prescribed in the ordinance of March 25th, 1915.

Therefore, during a time of a little over four years, three ordinances prescribing rates were adopted by the city council of Galveston.

It is clear therefore, that the city authorities of Galveston do not regard rates fixed by ordinance as static or unalterable. Rates may change, may

either be increased or lowered at any time, by rate-making authorities, to meet changed conditions.

Where the rates prescribed in any ordinance are attacked as confiscatory, we submit that, in arriving at a conclusion upon that question, the court should determine the value of the property as of the date when the ordinance becomes effective, should determine what would be such a minimum fair return on that value as would make confiscatory an ordinance allowing less than that return and then should determine what gross earnings are, or could reasonably be expected to be, derived under those rates, and what legitimate and proper expenses for operation and maintenance have actually been incurred by the company. If the court finds, after deducting such legitimate and proper expenses from such gross returns, that the remainder is not sufficient to provide for depreciation, and the return determined to be the minimum fair rate of return, the court should declare unconstitutional the proposed ordinance, no matter what the value of the property may have been at some date in the past, and no matter what the expenses may have been in the past, and no matter what prophetic views the court might entertain as to future increase or decrease, in the value of the property, the amount of gross earnings, or the amount of expense.

It seems to us that the question before the court always is: what are **the present actual facts?**

If the court, in any given case, holds that an ordinance prescribes rates which are at the time confiscatory, and if at some later time, the city authorities after investigation think that condi-

tions have changed so that lower rates would afford a fair return, there would be nothing to prevent the city from at such time passing another ordinance, reducing rates, provided such reduction does not at that time, result in confiscation.

Having once fixed the value of property, it would be a very easy matter for the court, at some later date, to ascertain whether prices had changed, and revise its valuation accordingly.

If by reason of changed conditions, there should be a change in gross revenue, or in operating expenses, this fact could be readily ascertained and the reasonableness of rates prescribed by any subsequent ordinance determined without difficulty.

If it be argued that this would entail endless litigation, we reply that the growth of rate litigation is not due so much to changes in values and conditions, as it is to the difficulty which rate making bodies and owners of public utilities and investors in their securities experience in endeavoring to forecast what **standard** of value any court will adopt in any given case.

If both the City of Galveston and the Brush Electric Company had definitely known in July, 1919, which of the two standards of value, i. e., pre war values or present values, would control in determining the reasonableness of rates, we doubt that this litigation would have arisen, because the dispute as to the primary question of value lies at the very root of this controversy and all similar controversies.

When the hearing before the Master commenced on August 26th, 1920, a year had passed from the

date when the ordinance by its terms would have become effective. The values agreed upon, printed record page 50, were as of date January 1st, 1920.

It seems to us that it is certainly fair that the values of that date should be taken in determining whether the ordinance, at the time it was passed, was confiscatory.

It is true that the rates prescribed by an ordinance may be non-confiscatory when the ordinance is adopted, and may later become confiscatory, but the court will not enjoin the enforcement of rates prescribed in an ordinance at a time when they are **not** confiscatory, because at some future time, they **might** become confiscatory; and on the other hand, the court should not refuse to declare void an ordinance fixing rates which, at the time when passed, are confiscatory, because at some future time, under changed conditions, the rates **may** become non-confiscatory.

In the first instance, the utility must wait until the rates actually become confiscatory before it can attack the ordinance, and in the other instance, when rates prescribed in an ordinance are confiscatory when an ordinance is passed, the court should declare the ordinance void at that time, permitting the city, when these or any other rates become non-confiscatory, to apply for a modification of the order. See **Smyth vs. Ames, 169 U. S., 466, especially concluding paragraph of court's opinion.**

There is no sound economic reason why electric light and power rates should be static. The price of

every other necessity and luxury alike is subject to change. Much rate litigation has been due to attempts by parties to forecast the future in making contracts embodying rates to be applicable for some time in the future, and to the attempt of courts to forecast the future and determine the present reasonableness of a rate by prophecy as to what future conditions may be.

We submit that the reason given by the learned court below, in sustaining defendants' objection to the Master's finding, as to the undepreciated value of the "bare bones," because prices and values were not static on January 1st, 1920, is sound neither in law nor in economics.

At some stage of this case, the court below and this court must decide definitely and positively the plain, simple question: Is the undepreciated value for rate making purposes of the "bare bones" of this property to be arrived at upon prewar average prices, (four to nine years prior to the time of the attack upon the prescribed rate) or upon prices presently prevailing, i. e., the **present value** of the property?

A definite decision of this question will not only serve to prevent much further litigation in the present case, but also to advise public utility companies and rate making bodies, as to what standard of value must be adopted in arriving at the primary basic figure in all rate litigation. Until the standard of the undepreciated value of the property is determined, all other factors in the problem are uncertain.

We therefore urge this court to determine this question definitely.

We know of no other case in the reported decisions of this court, where this question has been presented so pointedly, and where other testimony of doubtful value, such as historical cost, appreciation, book value, amount of stock and bonds outstanding, conflicting opinions as to value, etc., have been rendered so absolutely immaterial by a definite and clear cut agreement, between the parties.

We submit that, under the issues presented by this case, in view of the agreement by the parties, heretofore referred to, and under the decisions of this court, the value at present prices, (i. e. those obtaining when the property is being used in the public service, and when the controverted rate is in effect, and when its confiscatory nature is asserted) must be adopted.

In **San Diego Land and Town Company vs. National City, 174 U. S., page 739,** decided in 1899, this court, speaking through Mr. Justice Harlan, said, (on page 757):

> "What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property **at the time it is being used for the public.**

The reasonable value of this property at the time it is being used for the public was according to the agreement of the parties seven hundred eighty-four thousand, six hundred eighty-nine dollars ($784,689.00), the amount found to be its value by the Master, to which finding the court below sustained an exception.

In the earlier case of **Ames vs. Union Pacific, 64**

Federal, page 165, Circuit Judge Brewer said, (page 177):

> "Now, if the public was seeking to take title to the railroad by condemnation, **the present value of the property,** and not the cost, is that which it would have to pay. In like manner, it may be argued that, when the legislature assumes the right to reduce, the rates so reduced cannot be adjudged unreasonable if, under them, there is earned by the railroad company a fair interest on the actual value of the property. It is not easy to always determine the value of railroad property, and if there is no other testimony in respect thereto than the amount of stock and bonds outstanding, or the construction account, it may be fairly assumed that one or other of these represents it, and computation as to the compensatory quality of rates may be based upon such amounts. In the cases before us, however, there is abundant testimony that the cost of reproducing these roads is less than the amount of the stock and bond account, or the cost of construction, and that the **present value** of the property is not accurately represented by either the stocks and bonds, or the original construction account. Nevertheless the amount of money that has gone into the railroad property—the actual investment , as expressed, theoretically, at least, by the amount of stock and bonds—is not to be ignored, even though such sum is far in excess of the present value."

On appeal of the case to the Supreme Court, **(Smyth vs. Ames, 169 U. S., page 466,)** Mr. Justice Harlan, speaking for this court said, (pages 546 and 547):

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation * * * must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as to be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

In considering the language of Mr. Justice Harlan, it must be borne in mind that in the case of Smyth vs. Ames there was no agreement as to what the value of the physical property was, based upon prices applicable at the time of the attack upon the rates.

This was one of the early rate cases, and the court was feeling its way.

We doubt that any one would now seriously contend that the earning capacity of the property and the operating expenses and the net return should be considered in arriving at the value of the property, for rate making purposes, because that would be arguing in a circle.

The amount of market value of the bonds and stock of the company has long since ceased to have any probative value in determining the present value of the property.

We submit that under the more recent decisions of this court, the historical cost or the amount expended in construction and improvements have been discarded as the bases upon which the reasonable value of the property is determined.

Historical cost is of little assistance in arriving at present value, because, among other things, the cost of construction may include many items unwisely spent, and the scope of the inquiry would be unduly widened to investigate and determine the wisdom of such expenditures; further, property included in historical cost might have long since disappeared, due to obsolescence or replacement when the construction or installation of such property was found to be unwise or uneconomical; in short, the consideration of historical cost would involve the capitalization of mistakes in construction, or an interminable inquiry to isolate and identify such mistakes and deduct the cost thereof from the historical cost.

In the absence of agreement upon the value based upon present prices, or in the presence of conflicting opinion testimony as to the present value based on present prices, the court, as in the Galveston City Railway case, may be forced to consider the original cost, and in order to arrive at present values, add or deduct from the historical cost, an arbitrary percentage, representing the increase or decrease in present value over original cost; but when the cost of reproduction is agreed

upon, we submit, that is controlling, and eliminates from consideration any other less satisfactory evidence as to value.

We think indeed that a careful consideration of the case of Smyth vs. Ames will show that the fact which probably had the most potent influence upon this court, in affirming the decision of the Circuit Court was the fact that the secretaries of the Nebraska Board of Transportation reported to their Board in 1891 that freight rates in Nebraska should not be reduced, and said, **(page 549)**:

> "We have come to this conclusion not by taking the cost of construction and equipment, nor the amount of stock and bonds issued per mile, but by making our computations **upon the basis of what it would cost to duplicate the property at the present time.**"

In a later case, **Cotting vs. Godard—Kansas City Stock Yard, 183 U. S., page 79, 46 L. Ed., page 92,** Mr. Justice Brewer in 1901 said on **page 91**:

> "It, (the Supreme Court), has declared that the present value of the property is the basis by which the test of reasonableness is to be determined."

In the case of **San Diego Land and Town Company vs. Jasper, 189 U. S., 439,** decided in 1903, this court repudiated the theory that in passing upon the question of confiscatory rates, the value should be based upon the original cost.

In this case Mr. Justice Holmes says, on **page 442**:

> "The main object of attack is the valuation of the plant. It no longer is open to dispute that under the Constitution 'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the **time it is being used for the public.**' Citing San Diego Land & Town Co. vs. National City, supra. * * That is decided, and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses."

In the case of **Stanislaus vs. San Joaquin C. & I. Company, 192 U. S. 201,** decided in 1904, this court repudiated the original cost theory and held that the vital question was the value of the property at the time it was being used in the public service, and at the time of the attack upon the rate.

The Water Company sought to enjoin an order of the Board of Supervisors, fixing a rate; as the reproduction cost at that time was less than the historical cost, the Water Company sought to have the property valued on the basis of the historical cost.

The Board's valuation was,

> "based on prices of material, supplies and labor of the present date." **(113 Fed., 940.)**

The Board did not consider for any purpose the amount of complainant's investment, or the cost of the property; and its report shows that consideration thereof was entirely excluded and ignored.

The circuit court found that, as

> "No consideration was given by the Board to the evidence showing the amount of capital actually paid into the corporation, or the actual, reasonable and proper cost of the works." **(113 Fed., 942.)**
> "The value of complainant's property made by the Board of Supervisors, and the water rates fixed by the board with respect to such estimate did deprive the complainant of property without due process of law," **(113 Fed., 943.)**

This court reversed the decree of the circuit court, and approved the reproduction cost based on present prices, as adopted by the Board of Supervisors.

In the case of City of **Knoxville vs. Knoxville Water Company, 212 U. S., page 1,** decided January 4th, 1909, the Master's valuation was based upon the present cost of reproduction. The Master deducted from the cost of reproduction nothing for depreciation, and this was the sole criticism by this court, speaking through Mr. Justice Moody, of the method adopted by the Master.

In the case of **Consolidated Gas Company vs. City of New York, 157 Fed., 849,** the Master fixed the value of the company's property on the basis of reproduction at present cost. Judge Hough, in confirming the report of the Master, used the following language:

> "It is impossible to observe this continued use of the present tense in these decisions of the highest court, without feeling that the actual or reproductive value **at the time of inquiry** is the first and most important figure to be ascertained."

Later in the opinion, Judge Hough said:

> "As applied to a private merchant or manufacturer, the foregoing would seem elementary; but some difference is alleged to exist where the manufacturer transacts his business only by governmental license—whether called a franchise or by another name. Such license, however, cannot change an economic law, unless a different rule be prescribed by the terms of the license, which is some times done. No such unusual condition exists here, and, in the absence thereof, it is not to be inferred that any American government intended, when granting a franchise, not only to regulate the business transacted thereunder, and reasonably to limit the profits thereof, but to prevent the valuation of purely private property in the ordinary economic manner, and the property now under consideration is as much the private property of this complainant as are the belongings of any private citizen. Nor can it be inferred that such government intended to deny the application of economic laws to valuation of increments earned or unearned, while insisting upon the usual results thereof in the case of equally unearned, and possibly unmerited, depreciation." **157 Fed., 856.**

Upon appeal to this court, Wilcox vs. Consolidated Gas. Co. 212 U. S., 19, Mr. Justice Peckham, speaking for this court, said:

> "And we concur with the court below in holding that the value of the property is to be determined **as of the time when the inquiry is made regarding the rates.** If the property which legally enters into the con-

> sideration of the question of rates has increased in value since it was acquired, the company is entitled to the benefit of such increase. This is, at any rate, the general rule. We do not say there may not possibly be an exception to it where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public. How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the question when, if ever, it should be necessarily presented." **(212 U. S. p. 52.)**

The latter part of the language quoted, of Mr. Justice Peckham, does not apply to this case.

There may conceivably be an instance where allowing an adequate return upon the present value of a property would necessitate rates which would be unjust to the public, but in this case, as an injunction restraining the enforcement of the rates prescribed in the ordinance of 1919 would automatically put into effect the rates prescribed in the ordinance of 1918, (city authorities having prescribed these rates just a year before), this court could not say that they are unjust to the public.

We submit that the **Minnesota rate case, 230 U. S., 352,** (decided in 1913) when fairly construed, recognizes and approves the valuation based on the present cost of reproduction.

In the **opinion by Judge Sanborn, 184 Fed., 765,** the Master found the **present** value of the entire property of the carrier used in the public service

in the state of Minnesota. This valuation was as of June 30th, 1908, and was made on the basis of **reproduction new.** The master also made findings as to the original cost of the construction, and as to the **present** value, on the basis of cost of **reproduction new** of the entire system of the carrier.

In the opinion of this court, delivered by Mr. Justice Hughes, it was said:

> "In determining whether that right has been denied, each case must rest upon its special facts. But the general principles which are applicable in a case of this character have been set forth in the decisions.
>
> (1) The basis of calculation is the fair value of the property used for the convenience of the public * * * or as it was put in San Diego Land & Town Company vs. National City, supra, 'What the Company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public * * .'
>
> (2) The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper reconsideration of all relevant facts."

230 U. S., 434.

On page 454, the court said:

> "It is clear that in ascertaining the **present value,** we are not limited to the consideration of the amount of the actual investment. If that has been reckless or improvident,

> losses may be sustained, which the community does not underwrite. As the Company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value, **if it be more than its cost.** The property is held in private ownership, and it is **that property,** and **not the original cost of it,** of which the owner may not be deprived, without due process of law."

We submit therefore, that this case expressly discarded the original cost method of valuation, and in effect approved a valuation based on reproduction, at then present cost prices.

Two years later, in the case of **Des Moines Gas Company vs. City of Des Moines, 238 U. S., 153,** (decided in 1915), we think this court definitely accepted and approved the method of arriving at the fair value of the property, by taking the cost of reproduction new, at present prices, and that the opinion in this case, in effect, eliminates the other elements entering into valuation which were suggested in Smyth vs. Ames.

On page 161, Mr. Justice Day, speaking for this court said:

> "After valuing the real estate and various items of personal property as hereinafter stated, the Master adopted as the **only practical way** in his judgment of determining the reasonable value of the buildings, their contents, the yard structures, and the mains, house and street lamp services and meters, the process of estimating the **cost of reproducing them new,** and then estimating the

> depreciation which should be deducted, in order to obtain their present value."

On pages 161 and 162, this court said, speaking of the Master's report:

> "He first found what he thought was the base value of the property, i. e., 'what it would cost to reproduce it at the present time new, without adding thereto any overhead charges.' This figure he fixed at $1,975,026.00. To this he added overhead charges, fifteen per cent.,—$296,254.00. From this, he deducted depreciation, $334,878.00, leaving as the value of the property thus ascertained, $1,937,402.00"

On page 168, this court said, in approving the Master's report:

> "It is not a question of what was **actually expended therefor, in the plant in question,** but what **it would cost to reproduce a similar plant at the present time.** It is through this method we reach the **present value of this plant new,** and then when it is properly depreciated, according to the condition, life and age of its various parts, we reach the **present value** of the plant in its **present condition.** It is not a perfect method, but it is the **best method therefor,** and results **as nearly as possible** in giving the **present value** of the plant. **No other method** known has proved so satisfactory."

Three years later, in the case of **Denver vs. Denver Union Water Company, 246 U. S., 178,** this court, speaking through Mr. Justice Pitney said on page 191:

> "What we have said establishes the propriety of estimating complainant's property on the basis of **present market values** as to land, and **reproduction cost,** less depreciation as to structures. That this method was fairly applied by the special master hardly is disputed by appellants."

That the cost of reproduction at present prices less depreciation is the most significant if not the controlling figure in arriving at a fair valuation, is supported by the following authorities:

> **Whitten, on Valuation of Public of Public Service Corporations, page 69, section 72; Hayes, on Public Utilities, pages 18 and 217; Floyd on Valuation of Public Utilities, page 18.**

In the case of **Consolidated Gas Company of New York vs. Newton, 267 Fed., 236,** Judge Learned Hand uses the following pertinent language, speaking of the period of twenty months elapsing between January 1st, 1918 and August 31st, 1919, and then down to the date of the opinion, August 11th, 1920, (including the very period which is under discussion in the present case):

> "The present range of prices seems to me applicable not only to the cost of production, but to the valuation of the rate base; i. e., the permanent means of production, and this necessarily involves a decision upon the vexed question as to the values upon which the company is to be permitted to earn its profit. * * * It must be owned that much of the discussion shows either a timidity or an inability to grasp any principle in dealing with the 'rate base'. With deference, it appears to me to be merely an

> abandonment of any attempt to deal intelligibly with the question to say that cost of reproduction and the original cost are each elements to be considered. That statement can mean nothing whatever, unless it is accompanied by a constitutive rule which will establish some standard in the ascertainment of which these may be used. It would be understandable to say that the two estimates should be averaged, but such a rule could obviously command no support, because it would correspond to no relevant considerations of policy. Merely to leave the question with a caution that several elements are to be considered is to abandon any effort to solve it."

On page **237** Judge Hand goes into a discussion as to whether the present cost or the pre-war cost should be applied. He follows this discussion with the following language (page **238**):

> "The rule of the present reproduction cost which is a necessary consequence of the foregoing argument, appears to me to have been either expressly or implicitly recognized in all the cases in which the Supreme Court has passed on these matters."

In the next paragraph, Judge Hand goes on to say that the present cost is sometimes hard to prove. This is not true in the present case, because the present cost has been agreed upon.

The Newton case was appealed to this court, and was decided by this court, March 6th, 1922, _____**U. S. Reports,** page_____, **Advance Opinions April 15th, 1922, page 305.**

This court affirmed the decree of September 1920, being case 257, wherein a decree was drawn

in conformity with the opinion from which we have quoted. It is true that this court did modify the decree of the District Court, but only to the extent that the District Court attempted to fix rates. This court therefore tacitly approved the holding of Judge Hand, with reference to valuation, on the basis of present reproduction cost.

In the case of **Elizabethtown Gas Light Company, 95 New Jersey Laws, page 18, 111 Atlantic, 729,** the Supreme Court of New Jersey cites the **Lincoln Gas Company case, 250 U. S., 256,** in support of its conclusion, and says:

> "I think it entirely clear that the failure to allow for prices at the time to which the rates apply, July 1st, 1919, was an error. * * It would be manifestly unjust to apply to a gas company a standard of value different from that applied to others. To what extent the increase in prices may be due to an inflation of the currency or to any particular cause we do not know. What we do know is that the dollar of 1919 and the dollar of 1920 is worth less than the dollar of 1916 and still less compared with the dollar of the average year from 1911 to 1916."

As the dollar of 1920 is worth less than the dollar of 1916, the valuation of the plant, as of 1920, expressed in terms of dollars, must necessarily be proportionately greater than a valuation as of date 1916, expressed in dollars.

If the plant were located in Germany or Austria, could it be seriously contended that a present day valuation, expressed in marks or kronen based on average prices expressed in marks or kronen

prevailing during the period of 1911-1916 would be the "fair and reasonable value" contemplated by the law?

It is true the purchasing power of the dollar has not decreased to the same extent as has the purchasing power of the mark or the kronen, but the principle is the same; the difference is only relative.

Circuit Judge Stone and District Judges Van Valkenburgh and Wade, said in the case of **Joplin and P. Ry. Co. vs. Public Service Commission of Missouri, 267 Fed., 587:**

> "Great, if not undue emphasis is laid upon the original cost of the property * * * at a period greatly antedating that with which this investigation must deal; nor can we say that the present period of high prices is so temporary or abnormal that it may practically be disregarded in arriving at the value of complainant's properties. No one can say what degree of depression may ultimately come, but it is reasonably certain that the cost of the properties now under consideration will never again approximate figures prevailing in the years before the world war."

In support of this proposition, we cite also the following authorities:

National Waterworks Co. vs. Kansas City, 62 Fed. 865;
Matthews vs. Board of Corp. Commissioners, 106 Fed., 9;
Cumberland T. & T. Co. vs. Louisville, 187 Fed., 642;
Des Moines Water Co. vs. Des Moines, 192 Fed., 196;

L. & N. Railroad Co. vs. Railroad Commission, 196 Fed., 820;
Spring Valley Water Co. vs. San Francisco, 252 Fed., 989;
People vs. Wilcox (N. Y. Court of Appeals), 104 N. E., 915;
Murray vs. Public Utilities Commission, (Idaho Supreme Court), 150 Pac. Rep., 50;
State P. U. C. ex. rel. Springfield vs. Springfield G. & E. Co. (Ill. Supreme Court) P. U. R. 1920 C, 664-665.

On the appeal of the Galveston case to this court, Mr. Justice Brandeis said:

> "The basis for calculating reproduction cost adopted by all was **prophecy** as to the future general price level of commodities, labor and money. This predicted level, which they assumed would be stable for an indefinite period, they called the new plateau of prices. As to the height of this **prophesied** plateau, there was naturally wide divergence of opinion. The company's expert **prophesied** that the level would be 60 to 70 per cent above 1913 prices; the master, that an increase of 33 1-3 per cent would prove fair; and the court accepted the master's **prophecy** of 33 1-3 per cent. Thus, both master and court **assumed** a reproduction cost."

In this situation, this court apparently declined to indulge in further **prophecy**, and refused to disturb that prophecy which had the joint approval of two prophets.

In the present case, we present to the court, not prophecy, but facts agreed to by both parties.

We therefore respectfully insist that in this case,

this court should definitely decide that the undepreciated value of the "bare bones" of complainant's property for the purposes of this case, at any rate, is the sum of $784,689.00.

SECOND PROPOSITION

The court should have fixed the accrued depreciation of plaintiff's physical property at $207,984.84, being 28% of the agreed undepreciated value of the depreciable items included in the agreed valuation of the "bare bones." Assignment of errors numbers two, fifteen and sixteen.

The Master's report, printed record page 51, shows that the city contended that accrued depreciation should be deducted from the value new, on the basis of the "straight line method", taking into consideration only the age of the particular piece of property, and the arbitrary estimated rate of depreciation per annum; while the plaintiff and appellant contended that the accrued depreciation should be based upon an actual inspection of each piece of property, and a determination of the accrued depreciation based upon such inspection and the character of service rendered by each piece of property.

The Master reports that the engineer for the plaintiff testified that the percentage of depreciation of plants of the character and the age of the plant in question, was usually from fifteen to twenty-five percent (15% to 25%); and that the engineer for the defendant testified that such depreciation was usually twenty to forty percent

(20% to 40%). As this testimony ranged, according to testimony of two witnesses, between fifteen percent and forty percent (15% and 40%), the Master simply added the two estimates together and divided them by two, thus arriving at a percentage of depreciation of twenty-eight percent (28%), printed record, page 51:

> "The Master, doing the best he could under the circumstances, about divided the difference and adopted 72% of the condition or a depreciation of 28% from the cost of bare physical property, less real estate $20,000.00, and less office and utility equipment $15,757.00."

The court, in its opinion printed record page 294, said:

> "Being deprived of accuracy, and remitted to estimates, **I** shall take as **my depreciation allowance** 33 1-3 %."

It is perfectly apparent therefore that both the Master and the court did not take a "theoretical yard stick", but took two "theoretical yard sticks", and attempted to guess at an amount which would be indicated by the two different "theoretical yard sticks."

The Master evidently was of the opinion that the true yard stick was that which was midway between the two opposite extremes, while the court adopted one of his own, which was almost identical with the one which was most unfavorable to the Company. According to the Master's report, Mr. Elrod, Engineer for the city "thought that plants of this character are usually 60% to 80% efficient

as operating plants." The court decided that it was only 66 2-3% efficient.

This court, in the case of **Des Moines vs. Des Moines, 238 U. S., 153** speaking through Mr. Justice Day, quoted with approval the Master's report in that case:

> "It is through this method (cost of reproduction new at present time) that we reach the present value of this plant new, and then when it is properly depreciated, **according to the condition, life and age of its various parts,** we reach the present value of the plant in its present condition."

In the case of **Winona vs. Wisconsin, 276 Fed.,** District Judge Booth said, on **page 1004.**

> "I have some doubt whether 12% for depreciation is not too great, in view of the evidence as to the **present efficiency of the plant,** my view being that depreciation is something to be concretely determined by **inspection** rather than by a **theoretical yard stick,** and **present efficiency** is a very important factor; that even though the life of some of the elements of the physical property will not long continue, yet that is a matter to be taken care of by depreciation reserve; and that if the plant is practically as efficient as a new plant, the deduction from valuation on account of depreciation should be very slight."

Mr. Hamilton's testimony as to the manner in which he arrived at accrued depreciation is found on page **158 of the record (printed record page 127.** Among other things, he said:

"In arriving at that I do not take up each item of material and find when it was put in, and the time it has been in service, and calculate it—that is not the way I arrived at it. I get at that in this way; at the time my men made a detailed inventory of this property they made an inventory of the property, and determined from that **inspection,** and from the history of its life which they had, and from the **efficiency which our operating report shows it still had;** the amount of accrued depreciation; for instance, a pole, its depreciation would depend entirely upon the inspection; a generating unit would be determined upon the basis of the individual, but largely on the basis of its output of kilowatt hours in the proportion to the steam used, for instance, its efficiency. For others, it is done in exactly the same manner, I don't have a record of when a pole, for example, was put in. I don't believe that that record would be available except on a small portion of poles that have been installed lately. I do have a record of when a piece of machinery goes in and the time it has been used. That enters into my estimate of depreciation. The method I have described is the method by which this depreciation was determined and it is shown in these sheets." (Referring to Ex. 13, which has been certified and sent to the Supreme Court, as part of the record.)

See printed record, page 105 and 285, which detailed Exhibit shows the percent condition.

We ask the court to compare the method adopted by Mr. Hamilton in arriving at amount of accrued depreciation to be deducted from the cost of reproduction new, (Mr. Hamilton's method being

by inspection), and the method by which Mr. Elrod arrived at the accrued depreciation.

Printed record, page 147, Mr. Elrod says:

> "In making my depreciation estimates I adopted the 'straight line method',"

and on page 149, he says:

> "In estimating the value of Brush Electric Company's plant, by the cost method, I used the depreciation rate of 4% * * * It is necessary for engineers to establish some yard stick or rule of measure by which this depreciation can be uniformly arrived at."

Mr. Elrod testified, printed record page 168:

> "The service in Galveston compares favorably with that of any other city of its size. The equipment and lines are well maintained, and the entire property kept in as good condition as is practical."

nevertheless he testifies that he does not take into consideration the fact that the equipment and lines are well maintained, nor the condition of the property. He says, on page 177 of the printed record:

> "In determining the amount of depreciation on these several items, I used the "straight line method" of depreciation, that is, the multiplication of the rate of depreciation established by engineers generally by the age of the unit of equipment."

Applying this arbitrary, hypothetical yard stick, he arrives at curious results. On page 189, printed record, he testified that he depreciated the value of a 500 kilowatt rotary converter in the plant, by

the sum of $5030.30, which was 66 2-3% of the cost of reproduction. He did this upon the assumption that the converter was installed in 1903. He testified:

> "I have not any idea what is the efficiency of that machine in its present condition. **I determine my depreciation on the basis of age.**"

It developed on cross examination that this machine was not bought until 1917, and he admits that his theoretical depreciation of $5030.30 was wrong, according to his own theory, by the sum of $4250.00.

On page 190 of the printed record, he testified, with reference to boiler No. 3:

> "**My basis of determination of depreciation is again just its age. It was not affected in any way by its present operating efficiency.** The fact that the boiler inspectors for the Insurance Company now certify that for 170 pounds pressure would not affect it; nor would the fact that you could now sell that boiler for more than my value shown there, second hand * * * a purchaser of the boiler secondhand would not pay you anything for those foundations. If he was a dealer, he would expect to resell the boiler at a profit. But if he were still willing to pay you more money for the boiler by itself, than I have allowed you for it, that would not affect my determination at all."

In other words, this witness admitted that even though the Company could sell a boiler alone secondhand to a second-hand dealer, who would expect to make a profit out of it, yet because of his

theory of straight line depreciation, he would not allow for the boiler itself, which he admitted was in good condition and efficient, together with the foundations and settings, which were also in good condition, as much as the second-hand sale price of the boiler alone.

We respectfully submit that that sort of testimony is neither controlling nor persuasive in determining the proper amount of the accrued depreciation; and that when it has been developed that the witness Elrod paid absolutely no attention to the condition or efficiency of the property, in arriving at his estimate as to the amount of accrued depreciation his testimony with regard to accrued depreciation should be rejected entirely.

Nevertheless the lower court, on this witness' testimony that accrued depreciation ranged from 20% to 40%, took as the court's **guess** 33 1-3%.

We submit that the only testimony which had for its basis the elements which are necessary to be considered in arriving at the amount of depreciation was the testimony of Mr. Hamilton, and on that testimony, the rate of accrued depreciation which should have been applied was 15%, and that, at any rate, the rate of depreciation used by the Master of 28% was the very limit which should be used in this case.

The inaccuracy of Mr. Elrod in regard to depreciation is further shown by his testimony regarding the "live steam system" and the "blow off system", printed record pages 189 and 190. He depreciated both the "blow off system" and the "live steam system" on the theory that when the boilers became useless, the "live steam system"

and the "blow off system" would likewise become useless, and therefore applied to the latter two, the rate of depreciation which he applied to the boilers.

In this, he was in error, as shown by the testimony of Mr. Phipps, General Manager of the Company, on page 220, of the printed record. It appears that if the boilers became useless they would simply put new boilers in the same place, and continue to use the "live steam system" and the "blow off system."

We submit that the court should have sustained complainant's first and second exceptions to the report of the Master, (Assignments of error 15 and 16,) and should have over-ruled defendants' second exception to the Master's report, (Assignment of error number 2,) with the result that the court should have found as follows:

Value of bare physical property, undepreciated		$784,689.00
Less		
Real Estate	$20,000.00	
Office equipment (Ex. 13, pages 1 and 129)	15,327.00	
Utility equipment	6,559.00	41,886.00
Undepreciated value of depreciable physical property		742,803.00
Less depreciation 28%		207,984.84
Depreciated value of depreciable items		534,818.00

Add:

Real Estate	20,000.00
Office Equipment	15,327.00
Utility Equipment	6,559.00
Depreciated value of "Bare Bones"	$576,704.00

THIRD PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property should have allowed and included therein, as did the master, for contractor's expense and profit, 10% of the depreciated value of the depreciable items of physical property included in the agreed valuation, or the sum of $53,481.00. Assignment of error number 3.

The Master allowed for contractor's expense and profit, 10% of the depreciated value of the depreciable items, or the sum of $53,481.00. The defendants excepted to the amount of this allowance, (see defendant's third exception, assignment of error number 3.)

It will be noted by an examination of this assignment of error that the defendant does not appear to have objected to the item of 10% being allowed for contractor's expense and profit, but simply objected to its being allowed on the depreciated **present** value, and insisted that the allowance should have been 10% on the depreciated **pre-war** value.

It must be borne in mind that the agreement as to the "bare bones" valuation included simply the value of the separate pieces of property, not including, among other things, contractor's expense.

That is to say, it included only the bare cost of the items, and the bare labor of putting them in the place where they were.

Mr. Hamilton's testimony (See Ex. 13, page 129) was to the effect that contractor's expense and profit should be allowed on the basis of 12 1-2% of the depreciated "bare bones" value of $742,803.00, which would make the allowance for contractor's expense and profit $92,850.00.

Mr. Elrod, the city's engineer, testified on page 159, printed record:

> "Contractor's expense and profit were excluded from the agreement of August 25th, 1920, as to bare-bones value that has been introduced in evidence. **I allow ten per-cent** for contractor's expense and profit; Mr. Hamilton allows twelve and a half percent."

On page 185 of the printed record appears a tabulation made by Mr. Elrod, in which he allows for contractor's expense and profit 10%.

He testifies that where only historical cost is obtainable, of course, in arriving at historical cost you simply include such amount as was actually paid for construction; but on the reproduction basis you allow 10% for contractor's expense and profit.

The only dispute therefore between the two engineers was, **first**: whether the percentage should be 10% or 12 1-2%; and **second**, whether the pre-war value or the present value should form the base upon which the percentage was to be calculated.

The Master adopted Mr. Elrod's percentage of 10%, but as hereinbefore appears, took, and we

thought rightly, the **present** value, instead of the **pre-war** value. Nevertheless the court sustained this exception, and in arriving at his value, printed record page 298, allows 10% for both (a) contractor's expense and profit, and (b) Engineering and supervision, although each constitutes a separate item not included in the agreement.

These two items as allowed by the Master were 10% and 5% respectively, or a total of 15%, and we submit that the Master's allowance of these two separate items was supported by the uncontradicted evidence of the case.

FOURTH PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, as did the Master, for engineering and supervision $26,740.00, being 5% of the depreciated value of the items of depreciable physical property included in the agreed valuation. Assignment of error number 4.

The Master allowed for engineering and supervision, (printed record page 52) 5% of the depreciated value of the depreciable items, $26,740.00. The defendant excepted to this, (printed record pages 56 and 64), upon the ground that this 5% should have been based upon the pre-war value. The attack upon this part of the Master's report by the exception was not grounded upon allowance of five percent, but upon the base upon which that percentage was applied.

Mr. Hamilton's testimony with respect to the reason for such allowance appears on page 129 of the printed record.

Mr. Elrod, on page 159 of the printed record, testifies:

> "Now, in my reproduction theory, or reproduction estimate, I have estimated that such items of construction as were constructed by a contractor, or rather installed by a contractor and designed by an engineer, that engineering should apply on it, that five percent, which is the usual rate and the rate used by Mr. Hamilton on such work that was constructed by a contractor."

In the table prepared by Mr. Elrod, page 185 of the printed record, he also allows for engineering 5%.

It is true that Mr. Elrod testified that there was no engineering fee to be allowed for designing the various machines in the power house, because the engineering work of designing these machines was included in the cost of each machine. Nevertheless, it is perfectly clear that when a Company desires to construct a plant, to generate and distribute electric light and power to a community of a given size, it is necessary to first determine the probable peak load, at any time, what the probable lowest or valley load will be at any time, what the average load will be, what the operating factor will be, etc., and then determine what the kilowatt capacity output of the power house will be, and into how many generating units this capacity shall be divided, and the respective sizes of these several units, in order that the generating units may be used in such a way that each unit will at all times be operated as near as possible at its rated capacity.

The efficiency of a plant depends in a large meas-

ure upon the flexibility which is obtained by use at different times of the different sizes of generating units installed, according to the size of the load demand upon the station at such time. The size of various electrical generating units installed materially affects the decision of the engineer as to the sizes of the various steam generating units, and the other apparatus in the power house.

The location of the power house, and whether the plant shall be a condensing or non-condensing plant, and the method of obtaining water supply, and the method of cooling the water if the same water is to be used over and over again, by reason of lack of an abundant supply of cheap water, are all engineering questions requiring a high order of ability, which are not included in the engineering services incident to the design and construction of a particular electrical or steam generating unit.

The location of the poles and wires, the location and size of the various transformers, and the arrangement of the primary and secondary distribution system, all require engineering services of a high order.

According to the undisputed testimony of the witnesses for both parties to the case, 5% is a fair allowance for such engineering, and it is difficult to understand why the court should have lumped this with the contractor's allowance, and allowed for both these two entirely separate and distinct items 10%, when both parties agreed that 15% was fair and usual.

The only possible explanation for the court's action in this respect is that the court below, having made up his mind that because there had been

no test (although the defendant did not insist upon a test) and because the court thought that a reduction in rates might increase the business (although no exception had been reserved to the finding of the Master as to what the gross earnings would have been under the proposed rate), and because the court indulged in the prophecy that the then present prices were not stable, he ought not to declare the present rate confiscatory, shaved every figure that entered into the valuation down to make the valuation as low as possible, and then cut out every item of operating expense to which exception was made, in order, if possible, to justify by his figures the conclusion which he reached, based largely upon matters which were not disputed between the parties.

FIFTH PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, as did the Master, for omissions and contingencies $10,696.00, being 2% of the depreciated value of the items of depreciable physical property included in the agreed valuation. Assignment of Error Number 5.

The Master allowed, (printed record page 52) 2% on the depreciated value of depreciable property, for omissions and contingencies, the amount thus allowed being $10,696.00. The defendant excepted to this, (see Exception 5) and contended that nothing should have been allowed for this item.

The manner in which this exception differs in its

phraseology from the third and fourth exceptions will give point to the contention which we make that in the third and fourth exceptions the defendant did not object to an allowance of 10% and 5%, but only objected to the base upon which this percentage was calculated.

Mr. Hamilton's testimony, with reference to the claim of omissions and contingencies appears on page 129 of the printed record. He testified that 5% was fair, and stated that it was allowed to cover oversights in inventories, and also to cover such contingencies in the construction of the property as unexpected delays in receiving equipment and material, and the necessity of holding men awaiting the receipt thereof, unexpected pumping in excavation work and matters of that sort.

It is a matter of common knowledge that all contractors, after figuring the cost of material and the probable cost of labor, always add a percentage, usually 5%, for contingencies, and then to that add their profit.

It is also common knowledge and a matter of personal knowledge with some of us possibly, that the man who builds anything, from a chicken coop, to a house, and attempts to arrive at the cost of such construction by taking simply the cost of material, and the cost of labor, and allows nothing for contingencies, will make a grave mistake.

It is hardly probable that the plant which forms the subject of this litigation could be reconstructed without encountering unforeseen contingencies which would cost at least $10,000.00, in the course of such construction.

We submit that the Master cut this allowance

down to the very bone, and that the court erred in sustaining exception to the Master's report.

SIXTH PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, for interest during construction, $21,392.00, being 4% of the depreciated value of the items of depreciable physical property included in the agreed valuation. Assignment of Error Number 17.

The Master allowed for interest during construction $11,444.00.

The court in its opinion, did not specifically allow anything for interest during construction. He did allow $33,450.00 for organization and legal expense, interest and taxes during construction, and omissions and contingencies; whereas the total of such items allowed by the Master was $33,544.00, so that the court, while not sustaining defendants' exceptions to these particular items, shaved them down $94.00 in this instance.

We respectfully contend that there should have been allowed for interest during construction 4% of the depreciated value of the property, or $21,392.00.

Mr. Hamilton's testimony, with respect to the reason for this allowance appears on page 131 of the printed record.

Mr. Elrod, in his tabluation on page 185 allows 2%, or $11,444.00, which appears to be the exact amount which the Master took.

Mr. Elrod says, on page 180 of the printed record, respecting allowance of this item:

> "That is usually a matter of dispute as to the period required for the construction of the various items, or the plant as a whole, and the rate of interest, whether it should be six or eight percent."

On page 209 printed record Mr. Elrod testified that he based his allowance on six percent rate of interest, and four months as the time it would take to construct the property. On page 210 he testified "I have no idea that this property could be reconstructed in four months."

We respectfully submit that it would certainly take a year to reproduce this property, and that the amount upon which the interest is calculated would, during the period of one year, go from zero to 100%, and that the rate of interest should be figured at 8%.

Therefore 4% or one-half of 8% rate would be a proper amount for interest during construction, and the court should have sustained plaintiff's third exception, and allowed for this item the sum of $21,392.00.

SEVENTH PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property, should have allowed and included therein, for taxes during construction, the sum of $5,348.00. Assignment of error number 18. Plaintiff's 4th exception to report of Master.

The Master did not allow anything for taxes

during construction. Complainant's fourth exception to Master's report challenged this finding, and insisted upon an allowance of $5,348.00 for taxes during construction. Mr. Hamilton testified, (page 130 of the printed record) that the proper amount would be $6,670.00, on the basis of 8-10 of 1% of the valuation.

Mr. Elrod testified, page 158 of the printed record, that the Company had included its taxes in its operating expenses. The absurdity of this contention is readily apparent when we remember that there was, and necessarily could be, **no revenue during constructions,** and therefore as a plant is not in operation while it is being constructed, there were no "operating expenses" to which taxes could be charged.

In the case of **Galveston Electric Co. vs. Galveston, 272 Fed., 147,** the District Court allowed, for taxes during construction, the sum of $7,383.00. Why should such an allowance be denied in the present case?

EIGHTH PROPOSITION

The court, in arriving at the total present depreciated value of plaintiff's property, should have included therein, as did the Master, for "going value," at least the sum of $46,195.00. Assignment of error number six.

In considering the question of "Going Value" in this case, it must be borne in mind that the agreement between the parties covered only the undepreciated reproduction value of the "bare

bones", that is to say, the tangible physical property.

The agreement recited that in the agreed value the figures did not include anything for "Going Value," contractors' expense and profit, engineering and supervision, omissions and contingencies, organization and legal expense, taxes during construction, working capital, interest during construction, or material and supplies.

The Master, after deducting the accrued depreciation on the depreciable physical property, from the agreed valuation, allowed $46,195.00 for "Going Value", and also allowed something for each of the above listed items of intangibles, except the one item of taxes during construction, which has already been discussed.

He says frankly that he reached the conclusion that he should allow for "Going Value" the sum of $50,000.00, but that when he added up the other items of value, he fixed the "Going Value" at such a sum as would make the total valuation $800,000.00 in round figures.

As we have already argued, the Master omitted some items of value, and made some mathematical errors, and we insist that this court, in the consideration of this case, allow for "Going Value", the sum of $50,000.00.

The court below sustained an exception to the Master's allowance for "Going Value." With this going value stricken out, the remainder would represent only the cost of reproducing the physical property in place and ready to operate.

The property as thus valued would be ready to

operate, but not operating, without customers and without revenue.

It seems to us that it is perfectly clear that there is a difference between the value of a plant constructed and ready to operate, without any business whatever, and a plant already in operation, with gross earnings of over $300,000.00 per annum.

Something should be allowed for such difference in value, and that allowance is called "Going Value."

When the item of going value allowed by the Master was eliminated by the court, there was left in the items of valuation absolutely nothing that could be considered as including "Going Value." It was certainly not included in the agreed value of the "bare bones", because the agreement itself stated that it did not include the item of "Going Value." It was not included in contractors' expense and profit, nor in omissions and contingencies nor in engineering and supervision, nor in taxes during construction, nor in interest during construction, nor in working capital, nor in materials and supplies.

In some of the cases, it is included in "organization and legal expense", but in this case, the Master allowed for organization and legal expense, the sum of $11,404.00, which Mr. Elrod testified, (printed record page 179) was the exact amount "paid for legal expenses and drawing a charter and doing such other things as were necessary in connection with the transfer of the property in 1912 from the Brush Electric Light and Power Company to the Brush Electric Company."

Therefore it cannot be said that "Going Value,"

in this case, was included in the allowance for "organization and legal expense."

We respectfully submit that where, as in this case, the value is arrived at on the reproduction basis, there should be added to the value of the "bare bones" and the definitely named intangibles, something to cover the value of the entire property as a going concern.

The purchaser of such a property would expect to pay and the seller would expect to receive something to cover this "Going Value," and that amount, whatever it may be, is property, which cannot be taken for public use, without just compensation, and the owner of such property is entitled to a fair return upon its value.

The evidence shows that there is another electric plant in Galveston, and therefore this plant has competition.

Mr. Hamilton's testimony with regard to going value appears in the printed record, page 131.

Mr. Elrod's testimony with regard to going value may be summarized as follows:

He testified, on page 157 of the printed record, that "Going Value" was considered in making up his estimates, and that he arrived at it by adding up the deficits less than a fair return. On page 161, he testified that the losses of the merchandising department, amounting to $58,167.11, should have been included in the going value, but as the Company had charged them to operating expense, the amount of losses should not also be added to going value.

In other words, he admits that it actually cost the Company to acquire the customers which it

had, the sum of $58,167.11, and yet in estimating the present value of the plant on a reproduction basis, the defendants' counsel object to a going value of $46,195.00. On page 203 of the printed record, he says that, because the Company earned money in the past, he had allowed no going value.

Mr. Elrod approves of the Wisconsin method of arriving at "Going Value", which is to capitalize the losses. (See printed record, page 203.) If a property is losing money and has always lost money, according to his theory, it would have a going concern value, but if it were making money, it would not have a going concern value. His testimony on page 203, in this matter of going value is ingenious and will well repay reading. Mr. Elrod's ideas of value can be explained by two quotations of his testimony: (page 199)

> "I have applied a method of valuation to a public utility that is different from the bases I was adopting on anything else, and the prime reason for doing that is the fact that the public utility is different from other private property in that it has its life and operates through the grace of the people, by franchise, and the use of the people's streets and other privileges granted by the people."

And again on page 202, he said:

> "In other words I get your tax valuation as high as possible and your rate valuation as low as possible."

The court below, in his opinion, disposed of the item of "Going Value", in the following language:

> "The seventh exception to the allowance of "Going Value" will be sustained for the

reasons fully set out in the Galveston Electric case."

The case referred to is found in **272 Fed., page 147,** and was affirmed by this court April 20th, 1922,_____U. S., Reports, page_____, **May 15th L. C. O. Advance Opinions, page 382.**

We submit that the reasons set out in the Galveston Electric case for the disallowance of "Going Value", do not apply to the present case.

It appears that in the case referred to the parties agreed upon a historical reproduction cost. The court condemned the method of arriving at "Going Value" known as the Wisconsin method, respecting which Mr. Elrod testified, and which he attempted to apply in the present case, that method being the method of capitalizing past losses.

In the case referred to, Judge Hutcheson said, on page 159:

> "It might well be that a **rate-making body** would be justified in adding something of value to the plant as ascertained to compensate it for the lean years, and it might also be that in reviewing the action of such body a **court** or **master** might set up such a basis of valuation for itself, as, for instance, a "bare-bones" or junk valuation, as that to fairly determine the issue **some addition would have to be made on this score."**

In this case the parties agreed upon a bare bones value, and, to fairly determine the issue, some addition must be made on the score of "Going Value."

We recognize the fact that in a number of cases, this court has refused to allow anything for good will, especially where the Company in question en-

joyed a monopoly; and has also declined to allow anything for going value, when the fact that the property was a going concern had been taken into consideration, in arriving at other items of value; but we insist that these authorities are not applicable to the present case, where it is clearly shown that the item of going value has not been considered, in any way, in fixing any of the values allowed by the court or the Master.

In the case of **Des Moines Gas Co. vs. Des Moines, 238 U. S., 153, 59 L. Ed., 1244,** Mr. Justice Day said, on **page 165:**

> "That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self evident. This element of value is a **property right,** and should be considered in determining the value of the property, upon which the owner has the right to make a fair return, when the same is privately owned, although dedicated to public use. Each case must be controlled by its own circumstances, and the actual question here is: In view of the facts found, and the method of valuation used by him, did the Master sufficiently include this element in determining the value of the property of this Company for rate making purposes."

Mr. Justice Day then calls attention to the fact that in that case, the Master did consider the fact that the plant was in successful operation in arriving at his valuation of the physical property; while in this case the Master simply adopted the value agreed upon by the parties, which agreement by its terms showed that going value was not included.

Mr. Justice Day, in his opinion in the Des Moines case, refers to the opinion of this court, speaking through Mr. Justice Holmes, in the case of **Cedar Rapids Gas Light Co. vs. Cedar Rapids, 223 U. S. 665, 56 L. Ed., 594.** The Des Moines case reached this court by writ of error to the Supreme Court of Iowa. The opinion of the Supreme Court of Iowa is found in **144 Iowa, page 426; 138 American State Reports, page 299.**

The Supreme Court of Iowa said in that case:

> "To put a new plant in profitable operation, time would be required, and, aside from the intangible element of good will, the fact that the plant is in successful operation constitutes an element of value.
>
> As said, the value of the system as completed, earning a present income, is the criterion. In so far as influenced by income, however, the computation necessarily must be made on the basis of reasonable charges, for whatever is exacted for a public service in excess of this is to be regarded as unlawful.
>
> **Save as above indicated,** the element of value designated a 'going concern' is but another name for 'good will', which is not to be taken into account in a case like this, where the Company is granted a monopoly."

After a discussion of the items of value, the Supreme Court of Iowa said:

> "A careful review of the **entire record,** which has been repeated, has led to the conclusion that a fair valuation of the **entire plant** is somewhere between $300,000.00 and $350,000.00."

It would therefore appear that the Supreme Court of Iowa in this review of the entire record, took into consideration the "Going Concern Value," as distinguished from value of "good will," in arriving at its valuation of the entire plant as being $300,000.00.

Mr. Justice Holmes in delivering the opinion of this court, in the Cedar Rapids case, said, page 699:

> "Then again, although it is argued that the court excluded going value, **the court expressly took into account the fact that the plant was in successful operation.** What it excluded was the good will or advantage incident to the possession of a monopoly, so far as that might be supposed to give the plaintiff the power to charge more than a **reasonable price."**

We submit therefore that the Cedar Rapids case is authority for our contention, because in the present case neither the Master nor the court took into consideration the fact that the plant was in successful operation, nor has the appellant a monopoly of the electric light business in the city of Galveston.

In the case of **Denver vs. Denver Union Water Co., 246 U. S., 178, 62 L. Ed., 649,** it appears on **page 184** of the decision, that the Master allowed two items of value to which the appellant excepted, one being the value of water diversion rights, and the other an item of $800,000.00 for going concern value, which he allowed upon the ground that the Company had "an assembled and established plant, doing business and earning money", accord-

ing to the principle laid down by this court in the Des Moines case.

In passing upon the question of "Going Value" allowed by the Master in the Denver case, Mr. Justice Pitney said, on page 191:

> "Nor can it be doubted that the property must be valued as property in use * * * What we have said establishes the propriety of estimating complainant's property on the basis of present market values as to land and reproduction cost, less depreciation as to structures. That this method was fairly applied by the Special Master hardly is disputed by appellants, except as they contest the items allowed for "going concern value", and for the water rights acquired by complainant and its predecessors by original appropriation.
> With respect to the former item, we adhere to what was said in Des Moines Gas. Co. vs. Des Moines, 238 U. S., 153-165: 'that there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property upon which the owner has a right to make a fair return when the same is privately owned, although dedicated to public use.' As was then observed, each case must be controlled by its own circumstances. In the present case, the Master expressly declared that his detailed valuation of the physical property and water rights included no increment, because the property constituted an assembled and established plant, doing business and earning money; and a

> careful examination of his very elaborate report convinces us that this is true. The amount allowed by him is not open to serious question, from the standpoint of appellants."

We submit that the Denver case is directly in point, and is decisive of the question under discussion in our favor.

In the present case, the agreement expressly declared that the value of the "bare bones" did not include "Going Value," that is to say, to use just the language of Mr. Justice Pitney, it "included no increment, because the property constituted an assembled and established plant, doing business and earning money." The Master adopted that valuation, and no item of intangibles allowed by him, other than that denominated "Going Value", included any increment because the property constituted an assembled and established plant **doing business and earning money,** and therefore the Master fixed the sum of $46,195.00 to cover this increment, and the court below, under the authority of the Denver Water case, supra, should not have sustained exception thereto.

In the case of **Lincoln Gas and Electric Company vs. Lincoln, 250 U. S., 256, 63 L. Ed., 968,** the court recognizes the fact that something must be allowed for "Going Value." Mr. Justice Pitney said, on **page 267:**

> "Again we question the propriety of the Master's treatment of "Going Value" which he seems to have estimated at less than otherwise he would have placed upon it, upon the theory that the Company's busi-

> ness had been developed at the expense of the public, in the expenditure of past earnings exceeding a fair return upon capital invested, and this without any finding or any clear evidence to which our attention has been called that past earnings were excessive."

In the very recent case of Galveston Electric Company vs. Galveston, decided by this court April 10th, 1922, Mr. Justice Brandeis discusses the allowance of "going value", as applied to the facts of that case.

We have already called attention to a part of the language of District Judge Hutcheson, in his opinion in that case, 272 Federal, the quoted language being taken from page 159. He said also:

> "In view of the valuation used by the Master in this case of historical reproduction cost, with an appreciation added for the present-day valuations, with all overheads (see table below) properly added and allowed for * * * an allowance for going concern **in this case,** in addition to the allowance already made, as a basis for enjoining the exercise of a legislative prerogative must be discarded."

Among the items in the table referred to is the following: "Organization and Business Management, $73,281.00."

> Judge Hutcheson then goes on to say:
>
> "It is very evident that the parties, in making their agreement on value, and the master, in valuing the plant, valued it as a plant in use, and not in any sense as junk, or a dead and idle property. The agreement be-

> tween the parties showed plainly that they had included everything in the valuation of the property except the **franchise value, going-concern value in the sense of development cost,** bond discount, and brokerage, and it is evident that the master, in making his allowance for this item made it not for the purpose of making a distinction between junk and live value, but in order to add to his valuation an allowance for **development cost** somewhat analogous to the procedure earlier adopted by the Wisconsin Utilities Commission."
>
> On page 162, he says:
>
> "I have myself valued the property, as I think, in the light of the evidence, it should be valued, as a complete and going concern, useful and ready to serve the public, with its organization perfected and in shape, and its public ready and waiting to be served."

It will be noted that in the Galveston Electric case, there was the sum of $73,281.00 allowed for organization and business management, while in this case, there is an allowance for organization and legal expense of only $11,404.00, which amount is shown by the evidence simply to cover the charter fees for the present complainant Company, and the legal expense of transferring the property to the complainant from its predecessor. There is no allowance in this case for business management.

The Master, in the Galveston Electric case, in addition to the allowance for organization and business management, allowed a further sum of $520,000.00, for development cost, and the court on exception, eliminated this item of $520,000.00.

When the case reached this court, Mr. Justice Brandeis said:

> "The most important of these items is $520,000.00 for 'development cost.' The item is called by the master also 'going concern value, or values of plant in successful operation.' He could not have meant by this to cover the cost of establishing the system as a physically going concern, for the cost of converting the inert railway plant into an operating system is covered in the agreed historical value by items aggregating $202,000.00.
> These included, besides engineering, supervision, interest, taxes, law expenses, injuries, and damages during construction, the sum of $73,281.00 for the **expenses of organization and business management.** The going concern value for which the Master makes allowance is the cost of developing the operating railway system into a financially successful concern. The only evidence offered or relied upon to support his findings is a capitalization of the net balance of alleged past deficits in accordance with what was said to be the Wisconsin rule. * * * In determining the value of a business, as between buyer and seller, the good will and earning power due to effective organization are often more important elements than tangible property. Where the public acquires the business, compensation must be made for these, at least under some circumstances, (citing cases); and they, like past losses, should be considered in determining whether a rate charged by a public utility is reasonable. Compare C. H. Venner Co. v. Urbana Waterworks, 174 Fed.

348, 352. But, in determining whether a rate is confiscatory, **good will** and franchise value were excluded from the base value in Cedar Rapids vs. Cedar Rapids, 223 U. S., 665;
Des Moines vs. Des Moines, 238 U. S., 153; and the expressions in
Denver vs. Denver Union Water Co., 246 U. S., 178; and
Lincoln Gas Co. vs. Lincoln, 250 U. S., 256; are not to be taken as modifying, in any respect, the rule there declared. Going concern value and development cost, **in the sense in which the master used these terms,** are not to be included in the base value for the purpose of determining whether a rate is confiscatory."

As we understand this opinion of Mr. Justice Brandeis, he makes the very distinction that we are contending for. We do not claim any value for franchise or good will, but we contend that, under the facts in this case, there was absolutely nothing allowed to cover the cost of converting an inert electric plant into an operating system **doing business and earning money** or to cover that value which is referred to in the Venner case as follows:

> "I am of the opinion that the fair reproduction value of the property is $155,000.00, to which should be added $25,000.00, as the **going value** of the property, the definition of which is given by Mr. Justice Brewer as follows: 'that fact that it is a system in operation, not only with capacity to supply the city, but actually supplying many buildings in the city; not only with a capacity to earn, but actually earning; makes it true that the fair and equitable value is some-

> thing in excess of the cost of reproduction * * * It should pay therefore, not merely the value of a system which might be made to earn, but that of a system which does earn.' **National Waterworks Co. vs. Kansas City, 62 Fed., 865.**"

We therefore submit that under the decisions of this court, and under the facts in this case, the "Going Concern Value" of $46,195.00 was properly allowed by the Master, and the exception to this allowance should have been over-ruled by the lower court.

In further support of our contention, we cite the following:

> Floyd, Valuation of Pub. Utilities Properties, pp. 349-369;
> Bonbright vs. Geary, 210 Fed., 44;
> Pioneer Tel. & Tel. Co. vs. Westernhaver, 29 Okla., 429, 38 L. R. A. (N. S.) 1209, 118 Pac., 354;
> Re Public Service Gas Co., 1 N. J. P. U. C. 519;
> Public Service Gas Co. vs. Public Utility Comrs. 84 N. J. L. 463, 87 Atl. 651;
> People ex rel. Kings County Lighting Co. vs. Willcox, 210 N. Y. 479, 51 L. R. A. (N. S.) 1, 104 N. E. 911;
> Newburyport Water Co. vs. Newburyport, 168 Mass. 541, 47 N. E. 533;
> Gloucester Water Sup. Co. vs. Gloucester, 179 Mass. 365, 60 N. E. 977;
> Kennebec Water Dist. vs. Waterville, 97 Me., 185, 60 L. R. A. 856, 54 Atl. 6;
> Re Appelton Water Works Co. 6 Wis. R. C. 97;
> Missouri, K. & T. R. Co. vs. Love, 177 Fed. 493;

Galena Water Co. vs. Galena, 74 Kan. 644, 87 Pac. 735;
Norwich Gas & E. Co. vs. Norwich, 76 Conn. 565, 57 Alt. 746;
Brunswick & T. Water Dist. vs. Maine Water Co. 99 Me. 371, 59 Atl. 537;
Metropolitan Trust Co. vs. Houston & T. C. R. Co. 90 Fed. 683;
Bristol vs. Bristol & W. Waterworks, 23 R. I. 274, 49 Atl. 974.

NINTH PROPOSITION

The court should have fixed the rate base, or present fair depreciated value of all plaintiff's property, as a going concern, at $825,230.00. Assignments of Error, 7, 22, 23, 24, 25, 26, 27 and 28.

The Master reported that the value of the property for rate making purposes was $800,000.00. The defendant excepted to this finding (8th exception) and insisted that the total value of the property for the rate base should be $385,462.00.

The court found the total fair value to be $612,000.00. (See printed record pages 298-299.)

The court said, on page 298, that from the valuation of $784,689.00 he deducted

Real Estate	$20,000.00
Office and Utility Equipment	15,757.00
Working Capital	35,695.00
Material and Supplies	33,750.00

and that by making these deductions he reached a valuation of the depreciable physical property of $669,000.00. In this mathematical calculation, the court is in error.

The items which he deducts amount in the aggregate to $105,202.00, which deducted from

$784,689.00 leaves a balance of $679,487.00, so that the court here makes an error against the plaintiff of $10,487.00.

In addition to this, however, the court has deducted from the figure of $784,689.00, not only the real estate, and office and utility equipment, but two items of working capital ($35,695.00), and material and supplies ($33,750.00), which, under the agreement found on printed record page 50, did not form part of the "bare bones" value of $784,689.00; and by this means, the court makes an error against the plaintiff in this case of these two items, which aggregate $69,445.00.

On the theory adopted by the court, the "set up" figures would be as follows:

Undepreciated value of bare physical property		$784,689.00
Less		
Real Estate	$20,000.00	
Office and utility equipment	21,886.00	$ 41,886.00
Undepreciated value of depreciable property		742,803.00
Less		
Depreciation 33 1-3%		247,601.00
Depreciated value of depreciable items		$495,202.00
Contractor's expense and profit, engineering and supervision 10%		$ 49,520.00
Organization, legal expense, interest and taxes during construction, omissions and contingencies 5%		24,760.00
Working capital		35,695.00
Material and supplies		33,750.00
Real estate		20,000.00
Office equipment		15,327.00

Utility equipment	6,559.00

Base for rate making purposes $680,813.00

Therefore, under the court's own theory, the basis for rate making purposes would be $68,813.00 more than he figures.

The way the court below sets up his figures, he not only deducts from the agreed valuation items which are not included in it, to-wit, working capital, and material and supplies, but also deducts depreciation of 33 1-3% on the working capital, and material and supplies on hand.

We submit that under the testimony in this case, the proper base for rate making purposes is at least the following:

Agreed, undepreciated value of "bare bones,"		$784,689.00
Less		
Real estate	$20,000.00	
Office equipment	15,327.00	
Utility equipment	6,559.00	$ 41,886.00
Undepreciated value of depreciable property		$742,803.00
Less Depreciation as found by Master 28%		$207,984 84
Depreciated value of depreciable items		$534,818.00
Contractor's expense and profit 10%		53,481.00
Engineering and supervision 5%		26,740.00
Omissions and contingencies 2%		10,696.00
Organization and legal expense		11,404.00
Working capital		35,695.00
Interest during construction		21,392.00
Taxes during construction		5,348.00
Material and supplies		33,770.00
Going value		50,000.00

Real estate	20,000.00
Office equipment	15,327.00
Utility equipment	6,559.00
Rate Base	$825,230.00

TENTH PROPOSITION

The court should have found that the plaintiff company is entitled to an annual depreciation allowance of $40,605.57, being 4 1-2% of the undepreciated reproduction value of its used and usable physical property, complete and in operation, such undepreciated reproduction value being made up of the agreed value of the "bare bones" plus contractor's expense and profit, engineering and supervision, omissions, and contingencies, and interest and taxes during construction. Assignment of errors 8 and 21. Defendant's ninth exception.

The various positions assumed by the plaintiff, the defendant, the Master and the Court, with reference to the annual depreciation allowance, may be stated as follows:

(1) The plaintiff contends that the annual rate of depreciation allowance should be 4 1-2% of the undepreciated reproduction value of the physical property complete, that value being made up as follows:

Agreed value of the "bare bones	$784,689.00
Contractors' expense and profit, as allowed by the Master	53,481.00
Engineering and supervision as allowed by the Master	26,740.00
Omissions and contingencies as	

allowed by the Master	10,696.00
Interest during construction	21,392.00
Taxes during construction	5,348.00
Total	$902,346.00

See assignment of error twenty-one, printed record page 69.

On this basis, the total annual depreciation would be $40,605.57.

(2) The defendant contends that the annual depreciation should be at the rate of 4% per annum, based on the fair value for rate making purposes of the depreciable property, or in other words, that the base upon which the depreciation should be calculated be arrived at by deducting from the pre-war value of the depreciable property the accrued depreciation.

According to their contention, the depreciation should be 4% on $264,457.00 (See eighth and ninth exceptions to Master's report, printed record page 57.)

(3) The Master allowed 4 1-2% on his valuation of $800,000.00, or $36,000.00 per annum.

(4) The court sustained the eighth and ninth exceptions (see printed record page 295), and allowed a depreciation of $21,000.00 which he says is 4% "upon depreciables", Record p. 299.

The questions involved in this proposition are two:

(a) Upon what base should the rate of depreciation be calculated; and
(b) What is the proper rate of annual depreciation in the present case.

(a)

In order to determine the base upon which the depreciation should be calculated, we should consider the nature and purpose of a depreciation allowance.

In the **Knoxville Water Company** case, **212 U. S., pages 13 and 14:**

> "Before coming to the question of profit at all, the Company is entitled to earn a sufficient sum annually to provide, not only for current repairs, but for making good the depreciation and replacing the parts of the property, when they come to the end of their life. A Company is not bound to see its property gradually waste without making provision out of earnings for replacement. It is entitled to see that from earnings, the value of the property invested is kept unimpaired, so that at the end of any given term of years, the original investment remains as it was at the beginning."

Mr. Elrod, engineer for the city, testified page 148 of the printed record, as follows:

> "Depreciation is necessarily measured by money value. In a public utility, it is that part of the cost of the plant which has disappeared in the service of the public. It therefore follows that the amount of depreciation plus the present value of the plant (both values, of course, being based upon the actual cost) will always be equal to the original investment, so that, when an element of the plant has entirely disappeared from useful life in the plant, the depreciation value, if it has been provided in

> money during its life, will provide that much of the cost of the replacement; the balance being charged or credited to capital account. Thus, theoretically and in fact, always preserving the integrity of the investment."

On page 198 of the printed record, he testifies:

> "In line with the judicial and economic thought and all a man is entitled to a fair return on his money invested in a plant, for instance, a million dollars, he is entitled to a fair interest on it. He is entitled to have a depreciation fund fixed so that at the end of the life of that plant, say 25 years, he would either have that amount in money that he invested or he would have it in the plant worth just as much as when he started at the beginning."

On page 201 of the printed record, he testifies:

> "The depreciation fund is measured in dollars **and the integrity of the investment is the thing to be maintained.**"

Applying these statements to the facts in this case, we desire to direct the court's attention to the tables marked No. 1, on page 215 of the printed record, No. 2, on page 216 and No. 3 on page 217. These tables are based upon an assumed valuation of $1,000,000.00.

Table No. 1 shows that, if each year there is 4% of the undepreciated value of the property allowed for depreciation, there will have been allowed during the course of twenty-five years, exactly $1,000,000.00 for depreciation.

If none of the $40,000.00 set aside annually for

depreciation is used in the replacement of property, of course, the property will disappear, but the investor would have his million dollars. At the end of say six years, his property would only be worth $760,000.00. He would have been paid for depreciation $240,000.00. He might not be entitled to a return on more than $760,000.00, but we submit each year thereafter, he should still receive the $40,000.00 for depreciation.

At the end of the sixth year, he would receive, as a return, $60,800.00, being 8% on the depreciated value of his property, and whatever rate of interest he was able to obtain on the accumulated depreciation fund.

Mr. Elrod's cross examination, with respect to this table, is found on pages 194 and 195 of the record.

Table No. 2, printed record page 216, is based upon allowing an 8% return constantly on the original value of the property, and a depreciation fund of $24,020.00 annually, which if invested at 4% compound interest would accumulate $1,000,000.00 at the end of twenty-five years, which is the "sinking fund" method.

Mr. Elrod's cross examination with respect to this table is found on page 196 of the printed record.

By adopting either method, that is to say

> (a) The method of allowing a return each year only on the depreciated value of the property, and 4% depreciation on the undepreciated value of the property; or
> (b) Allowing an 8% return on the original value of the property and allowing only

2.4% depreciation on the original value of the property;

the investor receives, during the twenty-five year period, his money back, and his interest at 8% on the original value of his property.

We respectfully submit that the fair and proper way, and the one which follows necessarily from the decisions of this court, is that shown by table No. 1; that is to say, allowing the **rate** of **return** each year, only on the depreciated value of the property, but allowing the rate of **depreciation,** based upon the **value** of the **property new.**

Mr. Elrod's theory, and that which seems to have been adopted by the District Court, is to allow each year both return and depreciation based upon the then depreciated value of the property. In other words, assuming that the contention as to the allowances arose at the expiration of the sixth year, with respect to a plant that was originally worth $1,000,000.00, Mr. Elrod maintains, and he is supported by the Knoxville Water Works case, that, if the Company did not, in the past, charge enough and earn enough to set aside 4% of the original value of the property for depreciation, or if it has charged and obtained that 4% per annum but did not invest it in the property, it should not be entitled to a return upon that basis, because its property was not at that time worth as much as it was originally worth.

Moreover, he goes further and says that the depreciation should also be calculated upon the $760,000.00. In this, we submit he is in error, because the amount of the constantly lessening sum allowed for depreciation will not serve to return to

the investor the amount which his plant was originally worth, nor will it enable him to replace portions of the property from time to time, as they wear out or become obsolete.

That this is true was admitted by Mr. Elrod in his cross examination on page 213, of the printed record, when he said:

> "The rate of depreciation or rather the amount of depreciation as computed in the **annual** cost method, will not entirely replace the various units as they disappear."

In other words, he testifies on pages 198 and 201 that the object of the depreciation fund is to maintain the integrity of the investment, and on page 213, he admits that his method of calculating depreciation will not accomplish the object for which he says, correctly, a depreciation fund is provided.

The effect of Mr. Elrod's theory is graphically illustrated in table No. 3, page 217, of the printed record.

This table illustrates the theory of an 8% return on the constantly diminishing value of the property or rate base, and a constantly lessening amount of depreciation allowance, with the result that the depreciation fund, at the end of twenty-five years, will have amounted to only $639,603.96, and that the investor will have lost $360,396.04.

Mr. Elrod's cross examination with respect to this table is found on pages 197 and 198 of the printed record, with the result that he finally admits (page 197) that at the end of twenty-five years, the investor would have $360,000.00 invested that he had not collected depreciation for.

He takes refuge in the assertion that there will still be a junk value in the property, although he admits that the property, if not replaced, will absolutely disappear in twenty-five years.

Now, let us apply this to the present case. The Master says, printed record page 52, that the 4 1-2% is based upon the finding that the average life of the items entering into the property is approximately twenty-two years from the date of their installation.

Having deducted 28% for the accrued depreciation to date, it is apparent that the Master found that, according to the condition of the property, it had lost about 6 1-4 years of its useful life. It therefore had about 15 3-4 years of useful life left. Let us assume that the Company obtained, through its rates, the 28% of depreciation which the Master deducted, or $207,985.00. Let us assume further that, during the remaining 15 3-4 years, the Company was allowed 4 1-2% per annum on the depreciated value of the property, or $534,818.00. It would, during that period, receive $534,818.00 X 4 1-2% X 15 3-4, or $379,052.25, which, added to the $207,985.00 (accrued depreciation) would yield for depreciation, during the total twenty-two year period, $587,037.25, whereas the original value of the undepreciated property was $742,803.00, showing a loss of $155,765.00 Besides this, this calculation is based upon the theory that. from the sixth year on the depreciation allowance should remain constant. The loss would be much greater if, each year, the depreciation allowance was lessened by calculating the 4 1-2% upon the constantly decreasing depreciated value.

It seems to us that the incorrectness of Mr. Elrod's theory adopted by the court, as to the base upon which the depreciation should be calculated, is perfectly apparent, by a mere matter of mathematical calculation.

Applying this same theory to the court's figures, the result would be about as follows:

The investment in depreciable property, which should be preserved in its integrity is $742,803.00.

Deducting 33 1-3%, according to the court's theeory, we would have accrued depreciation, $247,601.00, and a present depreciated value of depreciable property of $495,202.00.

Now, let us assume that the Company has received from past earnings the $247,601.00 of accrued depreciation.

As the court's figures are based on 4%, and he figures a depreciation of 33 1-3%, it is apparent that, according to his theory, the property has lost 8 1-3 years of its useful life. At 4% its total useful life is estimated at 25 years. It therefore has remaining, according to the court's theory, 16 2-3 years. Calculating the future depreciation on this basis, we have $495,202.00 X 4% X 16 2-3, or $330,134.33, which would be the amount of depreciation which would be allowed in the future.

Adding to this, the $247,601.00 which the Company is supposed to have already obtained, we have a total of $577,735.33, while the investment to be protected was $742,803.00, showing a loss of $145,608.00.

This clearly demonstrates that annual depreciation allowance must necessarily be based upon the

undepreciated value of the depreciable items, which is $902,346.00.

(b)

With respect to annual rate of depreciation, Mr. Hamilton testified, printed record page 128, that, owing to the climatic conditions, and considering the nature of the property, a fair rate of depreciation would be 5%.

Mr. Elrod testified page 150, that the weighted average rate of depreciation for the property, as a unit, would be 5.8%, but that nevertheless,

> "We are **arbitrarily** using the usual rate 4%."

To the same effect is his testimony on pages 204 and 205 of the printed record.

It appears that the Master took the 5% contention of Mr. Hamilton and the 4% contention of Mr. Elrod, and "split the difference."

The court, however, probably influenced by his decision as to the rate of depreciation which he allowed in the Galveston Electric case, fixed the figure at 4%.

There is a difference between depreciation of different classes of property.

A water works property, which consists of little or no electrical apparatus, and is composed largely of steam generating units and pipes under ground, has a low rate of depreciation.

The same is true of gas property.

A street railway, while it has electrical generating apparatus at the power house, has a much smaller investment in poles and wires for distri-

bution than an electric plant, and practically no investment in transformers. It has a large investment in steel rails, which do not depreciate rapidly. Its road bed appreciates with time.

The investment in an eletrical plant, (like a telephone system, where 7% depreciation was allowed, **187 Fed., 652 and 653)** is composed, in a large degree, of rapidly depreciating property, such as electrical generating and transforming apparatus, and a large distribution system.

If 4% is fair on a street railway and 7% on a telephone plant, it would seem clear that 4 1-2% would not be excessive on an electric light plant; and we insist that the allowance for annual depreciation should be $40,605.00 which is 4 1-2% on $902,346.00.

ELEVENTH PROPOSITION.

The district court should have held that plaintiff company is entitled to earn as a fair return at least ten percentum per annum on the present fair going value of all its property; a return of ten percent being prescribed by article 1018 of the revised statutes of Texas, 1911. Assignment of error 20.

This court said, in **Wilcox vs. Consolidated Gas Company, 212 U. S., 19** on **page 48, 53 L. Ed., 398.**

> "There is no particular rate of compensation which must, in all cases and in all parts of the country, be regarded as sufficient for capital invested in business enterprises. Such compensation must depend greatly upon circumstances and locality; among

> other things, the amount of risk in the business is a most important factor, as well as the locality where the business is conducted, and the rate expected and usually realized there upon investments of a somewhat similar nature with regard to the risk attending them. There may be other matters which, in some cases, might also be properly taken into account in determining the rate which an investor might properly expect or hope to receive and which he would be entitled to without legislative interference. The less risk, the less right to any unusual returns upon the investments. One who invests his money in a business of a somewhat hazardous character is very properly held to have the right to a larger return, without legislative interference, than can be obtained from an investment in government bonds or other perfectly safe security."

In 1909, at the time this opinion was rendered, government bonds sold on a 3% basis; at the present time, they are selling on a 4 1-4% basis.

This is an increase in the rate of interest demanded on government securities of 41 2-3%.

If 6% was a fair rate of return on money invested in a gas monopoly in the largest city in the United States, in 1909, it would seem that 10% would be the minimum fair rate of return on an electric light plant having active competition in the city of Galveston, Texas, where the city is frequently injured by tropical hurricanes.

The legislature of the state of Texas evidently shares the same view, because Article 1018 of the Revised Statutes of 1911, state of Texas, provides:

> "The city council or board of aldermen shall

> not prescribe any rate or compensation which will yield less than ten per cent per annum net on the actual cost of the physical properties, equipments and betterments."

Article 1028 of the same Statutes, which does not apply to the city of Galveston, but by express provisions of Article 1026, applies only to municipal corporations incorporated under the general laws of the state, likewise provides:

> "The rates fixed must be sufficient to yield such public utility company not less than ten percent upon the investment."

Section 1018 does apply to the city of Galveston. Section 1028 does not, but it indicates what the legislature of Texas has considered a fair return for public utilities.

In the case of **Denver vs. Denver Union Water Company, 246 U. S., page 178,** Mr. Justice Pitney said, on page **194:**

> "The question of rate of compensation that may be regarded as sufficient depends greatly upon the circumstances and locality."

In the **Lincoln Gas Company case, 250 U. S., 256,** Mr. Justice Pitney said, on **page 268.**

> "It is equally well known that annual returns upon capital and enterprise the world over have materially increased, so that what would have been a proper rate of return for capital invested in gas plants and similar public utilities a few years ago, furnishes no safe criterion for the present or for the future."

We therefore submit that ten percentum per annum is a fair rate of return, and any rates yielding less than a fair rate of return are confiscatory.

TWELFTH PROPOSITION.

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the district court should have allowed, as did the Master, the sum of $2,330.00 for travelling expenses, as a reasonable and proper item of expense. Assignment of error number 9.

Defendant objected to the item of travelling expenses, $2,330.00, which form part of the general operation expenses, shown on page 116 of the printed record.

The Master over-ruled this objection.

Defendant excepted, (Defendant's eleventh exception); and the court sustained this exception along with the thirteenth and fourteenth, which relate to storm and fire expense, and valuation expense, and allowed $5,000.00 per annum to cover all three of these items, which amounted in the aggregate to $11,100.57.

It was not contended by the defendant that these amounts were not actually spent. There is no evidence in the record that the item of travelling expense is at all unusual.

It appears that the property is owned by H. L. Doherty & Company of New York, and that they own a number of other similar properties throughout the United States.

The court judicially knows that in order that a manager of property of this sort may keep in

touch with developments and improvements in the business, to enable him to improve the service rendered the people, it is advisable and necessary for him to attend state and national meetings of electric light associations, for the purpose of getting a change of views; and that in properties of this sort, it is necessary to attend meetings of the State Taxing Authorities, at the state capital, and that numerous other travelling trips are necessary and proper in a business of this kind.

We submit that when an expenditure, not on its face abnormal, is shown by the books to have been actually expended, and no evidence is submitted to show that it is unusual or that the amount is exhorbitant, such an item should not be arbitrarily disallowed.

It would entail endless testimony if the burden was upon the Company, whenever any item is questioned, to show that it was an item of expense which would constantly occur.

Before such item was disallowed, it seems to us that some evidence should be introduced to show that such item was unusual or unnecessary.

THIRTEENTH PROPOSITION

In determining the amount of net earnings which would be produced under the 1919 ordinance if enforced, the district court should have allowed, as did the Master, the sum of $14,024.27, for new business expense, as a reasonable and proper item of expense. Assignment of error number 10.

The Master allowed, for new business expense, the sum of $14,024.27, (see printed record page 53.)

The defendant excepted to it, as not being a proper item of expense. (See twelfth exception, printed record page 58.)

The testimony of Mr. Hamilton, with reference to the necessity of this expense, will be found on page 265 of the printed record, and that of Mr. Phipps, in regard to the matter will be found on page 223.

The new business department of an up-to-date electric light company operates an appliance and fixture store, where various fixtures and appliances for the use of electricity are displayed and sold.

The purpose of this is to induce the people who come into the store to purchase these fixtures, and thereby increase the consumption of electrical current. The Company does not attempt to make any profit by the sale of appliances. To do so would be to defeat the very object of operating the department.

By selling the appliances as nearly at cost as possible, they bring about the purchase of the appliance, and once it is purchased, it usually continues to consume current.

Occasionally this department effects the sale of a motor or a number of motors, for some manufacturing plant, and when this occurs, at rare intervals, the department shows a profit.

The court disallowed this item and sustained defendants' exception thereto, not upon the grounds raised by the exception but upon the ground that the court **prophesied** that in the future this department would be operated at a profit, rather than at a loss.

Mr. Phipps testified, page 223 of the printed record, that the loss in this department, during the last five years, had amounted to $58,000.00, or an average of $11,600.00 per annum. This is corroborated by the testimony of Mr. Elrod, printed record page 161.

It appears that it lost, for the year ending July 31st, 1920, the amount allowed by the Master. It appears furthermore, (from the statement which forms page 342 of the printed record, but which is inserted between pages 270 and 271), that, during the calendar year of 1920, it actually earned a profit of $7,692.00, and the court thereupon concluded that it would continue to operate at a profit.

We submit that the Master was correct in allowing for the year ending July 31st, 1920, the amount actually lost, and that in forecasting the future, the court should have allowed for this purpose, at least the average amount lost during the preceding five years, which would be $11,600.00.

FOURTEENTH PROPOSITION

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the district court should have allowed, as did the Master, the sum of $2200.21 for storm expense, and the sum of $6379.99 for fire expense and $200.00 for valuation expense as reasonable and proper items. Assignments of error number 11 and 12.

The Master allowed for storm expense $2200.21, and for fire expense $6379.99, and the defendants

excepted to these allowances in their thirteenth exception.

The court sustained the exception, and allowed for travelling expense , storm expense, fire expense, and valuation expense, the sum of $5000.00, whereas these items as allowed by the Master aggate $11,100.47.

We have already discussed the question of travelling expense.

Regarding fire expense, it appears that there was a loss occasioned by fire in 1919. (see Mr. Elrod's testimony, printed record page 176.) It appears, from the statement on page 238, that the loss not covered by insurance amounted to $15,617.99, and that there was charged off in 1919, the sum of $2250.00, leaving $13,367.99 to be charged off after December 31st, 1919.

The Master allowed approximately one half of it to be charged during the year ending June 30th, 1920. It would certainly seem that a loss through fire should not be carried indefinitely on the books, and that to spread it over two or three years would be proper.

In reference to storm expense, we beg to say that the court takes judicial knowledge of such things as storms. From the records of the Weather Bureau, these storms occur frequently along the Gulf coast, and in Galveston, and have so occurred since the year 1837.

It appears from these records that Galveston was submerged on the 1st of October, 1837; again in 1842; again in 1854; again in 1867; again in 1871, when two storms occurred, one in June and one in October; again in 1875; again in 1885; again in

1886, the storm of September 4th, 1886, causing damage to the city of Galveston greater than that ever sustained up to that time, by any American city, causing property damage to the amount of $17,000,000.00, and resulting in the loss of six thousand lives.

In September, 1900, another terrible storm visited Galveston, known as the "great Galveston disaster"; in 1909 another storm visited Galveston; another August 17th, 1915; and another in 1916. Other storms occurred September, 1919, and June, 1921. The last storm occurred since the court wrote its opinion, saying that the record does not show that this expense is usual or customary or any thing more than occasional.

We submit that the records of the Weather Bureau show that it would be proper to make such annual allowance for storm expense in the city of Galveston.

We shall not discuss at length the twelfth assignment of errors, involving the valuation expense of $200.00, because it seems clear that an expense as small as this for valuing a Company's property should certainly be allowed.

We therefore submit that the court should have, as the Master did, allowed $11,100.47 to cover travelling expense, storm expense, fire expense and valuation expense, as a reasonable and proper charge, and as liable to occur at any time.

FIFTEENTH PROPOSITION

In determining the amount of net earnings which would be produced under the 1919 ordinance, if en-

forced, the district court should have allowed, as did the Master, the sum of $47,534.29, for maintenance expense. Assignment of error number 14.

The Master allowed for maintenance $47,534.29. The defendant objected to the amount of this allowance, chiefly because the amount allowed was greatly in excess of the amount expended by the Company for maintenance during the years 1917, 1918 and 1919, and insisted that the amount that should be allowed was $22,784.00.

The court sustained the exception and allowed $25,000.00, based upon an estimate of 5% of the depreciable value of the property.

We contend that it is not possible to figure maintenance by any rule of thumb. If a public utility should adopt the policy of fixing a certain percentage of the value of its property, as the amount to be expended in maintenance, and refuse, under any circumstances, to spend more, its property could not be kept up so as to properly serve the public.

But assuming that it is feasible to adopt a hard and fast rule, and say that 5% of the value of the property is all that should be allowed for maintenance, it occurs to us that the court's idea of allowing this percentage on the depreciated value of the property is clearly erroneous.

It certainly costs as much to maintain property which has by age suffered a 28% depreciation, as it would to maintain that property if it were new.

We have argued under the tenth proposition that the rate of annual depreciation allowance should

be based upon the value of the property new, and we insist that the amount allowed for maintenance should be based upon the same figure.

The undepreciated reproduction value of the physical property complete is $902,346.00. 5% of that amount would be $45,000.00, or approximately what the Master allowed.

It appears from the court's opinion, printed record page 297, that the cost of maintaining the property has steadily increased, except for the calendar year of 1917 and 1918. It would seem that this increase would be brought about, not only by an increase in the cost of the materials and labor entering into the maintenance, but by the fact that it would naturally cost less to maintain property when it is new, than it would when it is old.

The record shows that the money was actually spent. There is nothing in the record to show that it was unnecessary or unwisely spent. It went into the property.

SIXTEENTH PROPOSITION

In determining the amount of net earnings which would be produced under the 1919 ordinance, if enforced, the district court should have allowed, as did the Master, the sum of $750.56 for condemned meters, and $75.03 for condemned transformers. Assignment of error number 13.

The Master allowed the above stated amounts over the objection of the defendants. The defendants excepted and the court sustained the exception, upon the ground that these items should have been taken care of in the depreciation reserve.

We do not care to argue this at length. We feel confident that this court will sustain our proposition that the annual depreciation allowance should be based upon the undepreciated value of the property, and in that event, we admit that these items should be charged to depreciation reserve, but if the theory of the district court is correct, that annual depreciation allowance should be based upon depreciated value of the property, then there would not be any depreciation reserve, against which to charge these two items.

SEVENTEENTH PROPOSITION

The enforcement of the ordinance of 1919 should have been enjoined without requiring plaintiff company to make any actual test of the rates therein prescribed.

Because:

(a) The defendants, in the district court, in effect waived such a test, and urged the court below to pass upon the constitutionality of the ordinance, without requiring such test;

(b) The defendants did not except to the finding of the Master, as to the amount of gross revenue, which would be derived by plaintiff Company, under the rates prescribed by the 1919 ordinance, if enforced;

(c) Said ordinance of 1919 was adopted by the Board of Commissioners of the city of Galveston, without any valuation of complainant's property, or any investigation, examination or audit of its business, properties, earnings or expenses, and on the contrary was adopted by a newly elected Board

of Commissioners, who, during a political campaign, in order to secure their own election, promised to reduce electric rates, and immediately after taking office, adopted said ordinance, without consideration or investigation, in order to carry out their pre-election promises.

(d) The evidence and the report of the Master shows that the rates prescribed by the 1919 ordinance, if enforced, would be clearly confiscatory.

This proposition is covered by assignment of errors, numbers twenty-two, twenty-three, twenty-four, twenty-five, twenty-six, twenty-seven and twenty-eight.

We have already, in this brief, argued (a) and (b). We have also discussed (c). For fear, however, that this court may confuse this case with the street railway case, known as the Galveston Electric Company vs. Galveston case, decided by this court, April 10th, 1922, we desire to call the attention of this court to the difference between the record in this case, and the statement of facts made by Mr. Justice Brandeis in the Galveston Electric case.

In his statement of facts, Mr. Justice Brandeis said:

> "At no time has the full fare on the railway been more than 5 cents, except during the period of eight months, from October 1st, 1918 to June 1st, 1919, when 6 cents was charged. This higher fare was authorized by ordinance of the Municipal Board of Commissioners, which possessed regulatory powers, and on June 5th, 1919, the **same Board** reduced the maximum fare to 5 cents. The latter ordinance **was passed after a**

> **hearing and a finding by the Board that, with the reduced rate, the Company would continue to earn a fair return."**

In the latter part of the opinion, Mr. Justice Brandeis said:

> "There was no suggestion that the action of the Board evidenced hostility to the utility, or that the Board was arbitrary or hasty. It had been theretofore considerate of the Company's rights and needs. When prices rose rapidly in 1918, it raised the fare limit to 6 cents, although the franchise ordinance prescribed the 5 cents fare. * * * Its reduction of the fare by ordinance of June 5th, 1919 was made after hearing."

We are not advised as to what the record showed in the Galveston Electric Company case, but the record in this case clearly shows that the Board which adopted the electric rate ordinance of 1919 was **not the same Board** as the Board which granted the increase in electric rates, by the ordinance of 1918.

The Board of 1918 made some increase in rates, and because they did so, they were put out of office, and a new Board was elected, which was pledged to a reduction in rates. (See testimony of Mr. Cavin, printed record page 249.)

It is apparent therefore that we have here not an instance of recall of judicial decisions, but a recall of judges, because of a decision which they rendered, and added to that, what practically amounts to popular initiative of judicial decisions.

The rate-making Board consists of the city commissioners who perform a quasi judicial function

in fixing rates. Because the Board of 1918 exercised that function, the populace in Galveston, within a year, declined to re-elect them, and elected a new Board, who went into office, with a pre-election pledge that they would not do what the old Board had done, that is raise public utility rates, without submitting such rates to a **vote of the people.**

We submit therefore that the action of the present Board is in this regard, at least tainted with the suggestion that the Board evidenced hostility to this utility and the fact that the new Board adopted the 1919 ordinance the day after the "return day" of the citation to the company, and made the rates prescribed effective immediately, indicates that the Board was both arbitrary and hasty.

Under these circumstances we submit that this court will not indulge any presumptions in favor of the fairness of the rates prescribed by the 1919 ordinance.

In this connection, we call attention to the opinion of Mr. Chief Justice Taft, in the case of **Wichita Railroad vs. Public Utilities,** decided by this court November 13th, 1922.

We recognize the fact that there are many cases where the Federal District Courts and this court have refused to enjoin the enforcement of rate ordinances, until the rates prescribed had been subjected to a test, but we submit that in no case where that rule was applied, has it appeared from the record, that the rate ordinance was adopted under circumstances similar to those which surround the adoption of this ordinance. We shall not quote from these cases, but content ourselves

with asking that this court compare the circumstances surrounding the adoption of the ordinances in those particular cases, with the circumstances surrounding the adoption of this ordinance.

A typical case is **Knoxville vs. Knoxville Water Company, 212 U. S., 1, 53 L. Ed., 371,** where the court said:

> "The city authorities acted in good faith, and they tried, without success, to obtain from the Company a statement of its property, capitalization and earnings.

(d)

It has been frequently laid down by this court, as appears in the opinion in the Knoxville Water Co. case, that "The courts in clear cases ought not to hesitate to arrest the operation of a confiscatory law."

> Ames vs. Union Pac., 64 Fed., 165;
> Smyth vs. Ames, 169 U. S., 466;
> Seaboard Airline vs. Railroad Commission, 155 Fed., 792;
> Georgia vs. Railroad Commission, 161 Fed., 925.

We submit that the rates prescribed by the ordinance of 1919 are clearly confiscatory.

The estimated gross income as found by the Master and adopted by the court is	$277,267.39
Less operating expenses and maintenance, as allowed by the Master	228,621.73
Net earnings applicable to depreciation and return	48,645.66
Depreciation being 4 1-2% of the un-	

depreciated reproduction value of depreciable physical property, $902,346.00, or	40,605.50
Balance applicable to return	$ 8,040.16

or about 1% on the rate base.

Or assuming that this court will adopt the lower court's idea with respect to eliminating in part, or reducing the amounts allowed as part of the operating expenses, for the items of travelling expense, new business expense, storm expense, fire expense, and valuation expense, this would have reduced the operating expenses by the sum of $20,924.00, with the result that the operating expenses would be, as found by the Master, $228,621.73, less $20,924.00 disallowed by the court, or $207,697.73, and the result would be as follows:

Income	$277.267.39
Less operating expense and maintenance	207,697.73
Earnings applicable to depreciation and return	69,569.66
Less depreciation	40,605.50
Balance applicable to return	$ 28,964.16

or about 3 1-2% on the rate base.

Or should this court adopt the figures of the lower court, with respect to operating income and operating expense, and adopt the court's idea that maintenance should be limited to 5%, and apply that percentage to the undepreciated value of depreciable items, the result would be as follows:

Income	$277,267.39

Operating expense	160,163.00
Balance applicable to maintenance, depreciation and return	117,104.39
Less maintenance 5% on $902,346.00, or	45,117.30
Balance applicable to return and depreciation	71,987.09
Depreciation	40,605.50
Balance applicable to return	$ 31,381.59

or less than 4% on the rate base.

In conclusion we call attention to the fact that in estimating the amount of operating expenses, the court below, to say the least, was optimistic in his prophecies. He disallowed more than one half the amount the Company had actually spent for travelling expenses, storm expense, fire expense and valuation expense, upon the theory that there would be no more fires or storms, and that no further valuation of the property would be necessary. In the face of five years experience, as shown by the records of the Company, he prophesied that the new business department in the future would make money, and therefore he disallowed this item of expense.

He proceeded upon the theory that the sales of appliances would result in sufficient profit to pay all of the soliciting forces of the Company.

On the other hand, he refused to look upon the dark side of the picture, even though it was definitely proven that the Company was then enjoying an oil contract which greatly reduced its expenses, and that that contract would expire April

1st, 1921, said contract being on the basis of 90c per barrel for oil (See Mr. Hamilton's testimony printed record pages 256 and 257.) The lowest price which the Company could get at that time for a new contract was $2.00 per barrel for Mexican Crude, a difference of $1.10 per barrel, plus switching charge of $8.76 per tank, which would make $2.40 per barrel,—a difference of $1.50 per barrel. The increase in expenses which would result from this is shown on page 254 of the printed record, showing that the cost of fuel for 1920 was $58,066.29, and that based on the existing contract until April 1st, 1921, and on the price of $2.40 per barrel to the end of the year 1921, the cost of fuel would be $124,383.29.

The increase in expenses, therefore, certain to result from this one item alone is $66,317.00, and yet the court refuses to take that fact into consideration at all, and deducts from the present actual expenses the sum of $20,924.00.

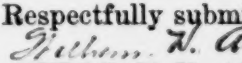
If we are to indulge in prophecy as to future operating expenses, we submit that even accepting the court's prophecies as to cost of maintenance, and accepting his allowance for operating expenses, and adding thereto this certain item of increase in the operating expenses, we would find the result to be as follows:

Income as adopted by the Master and the court		$277,267.39
Less Operating expenses allowed by the court	$160,163.00	
Increase by reason expiration fuel contract	66,317.00	

Estimated operating expense	226,480.00
Balance applicable to maintenance, depreciation and return	50,787.39
Maintenance allowed by the court	25,000.00
Balance applicable to depreciation and return	25,787.39
Depreciation	40,605.50
Deficit of a sufficient amount to take care of depreciation	$ 14,818.11

We respectfully submit that the decree of the lower court should be reversed, and the cause remanded with directions to enter a decree granting the injunction prayed for.

Respectfully submitted,



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IN THE

Supreme Court of the United States

October Term, 1922.

No. 179

BRUSH ELECTRIC COMPANY,

Appellant.

vs.

CITY OF GALVESTON ET AL.,

Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF TEXAS

BRIEF FOR THE CITY OF GALVESTON ET AL., APPELLEES.

STATEMENT OF FACTS.

We will take it for granted that the Master's report (Record, p. 49) and the opinion of the trial judge (Record, p. 292) have been read. On the day following the filing of the opinion in this case, Judge Hutcheson filed his opinion in Galveston Electric Co. vs. City of Galveston, 272 Fed. 147, to which he made reference for a further statement of his views. On appeal the latter case was, on motion, advanced

and decided April 10, 1922, Mr. Justice Brandeis delivering the opinion of the Court. That decision in some particulars rules the case at bar. We call special attention to Judge Hutcheson's opinion in the Galveston Electric case, because it is believed to be a real contribution to the law of rate litigation in the Federal Courts.

This business was started in 1881, when a charter was issued under the Texas laws to Brush Electric Light and Power Co., with an authorized capital of $150,000.00, which was increased to $250,000.00 in 1910. The records prior to 1890 are fragmentary (Exhibit 16, pp. 23-5); but, beginning February 1, 1890, the engineer employed by the City found the records complete as to plant value, additions to plant value, revenue and disbursements (Exhibit 16, pp. 85-6; Record, p. 154). In Column 2 of the table inserted between pages 152-3 of the printed record is shown the additions to the plant value from year to year which reflect the growth of the plant. The property was sold to Appellant, Brush Electric Co., a Delaware corporation, in 1912, as a going concern, and it has conducted the business since.

This bill was filed August 21, 1919, (Record, p. 3). The Master heard evidence between August 26 and September 30, 1920, and filed his report October 12, 1920 (Record, p. 49). The District Judge decided the case February 9, 1921 (Record, p. 292). The final decree dismissing the bill without prejudice was entered March 1, 1921 (Record, p. 62). Before the case was decided by the District Judge, plaintiff's operating experiences were brought down to January 1, 1921, and further evidence heard before the District Judge (Record, p. 251). On this evidence, in addition to that heard by the Master, the Court decided the case.

On the day before the Master began taking evidence, the following agreement was made:

"Galveston, Texas, August 25, 1920.

"We, the undersigned engineers for the Brush Electric Company and the City of Galveston, respectively, in the matter of the valuation of the properties of the Brush Electric Company, of Galveston, Texas, agree to the following valuations of said properties:

Cost of bare physical property, at present prices, undepreciated, as of January 1, 1920	$784,689.00
Cost of bare physical property, at averaged pre-war price, undepreciated, as of January 1, 1920	576,898.00

It is understood that the above figures cover only the 'bare bones' of the properties, and do not include the following intangible, and other values:

Contractor's Expense and Profit.
Omissions and Contingencies.
Engineering and Supervision.
Organization and Legal Expense.
Taxes during Construction.
Working Capital.
Interest during Construction.
Materials and Supplies.
Going Value.

ANDREW J. FOSTER,
For the Brush Electric Company.

HENRY E. ELROD,
For the City of Galveston." (Record, p. 50)

By "averaged pre-war prices," the parties meant the average of prices prevailing during the 10 years prior to the entry of the United States in the war, i. e., the average of prices prevailing prior to January 1, 1917, which were higher than pre-European war prices. (Record, pp. 259, 293.)

There were six items constituting the physical property that the engineers had in mind in making the agreement, to-wit:

Real Estate.
Buildings and Structures.
Power Plant Equipment.
Distribution System.
General Office Equipment.
Utility Equipment. (Record, p. 104.)

Mr. F. C. Hamilton, for Appellant, at the hearing before the Master, estimated the cost of reproduction, new, of an identical plant at present-day prices. The theory upon which he proceeded is disclosed by his evidence on page 226 of the printed record:

> "I made no examination to ascertain whether the books in fact disclosed any charges upon which to base my estimate on the overhead, and I would not have paid any attention to them if they had. The books had absolutely nothing to do with it whatever. * * * On the theory of the reproduction of the plant, say, at the date of this hearing, I would estimate what it would cost to build that plant as of this date as if there was no plant there. Therefore, whatever the plant may have actually cost has nothing to do with it. It is what it will cost to build it today—exactly as I would determine the value of any other article in the world. * * * If the books of the Company show anything with reference to overhead as having been incurred by the present Company or its predecessor, I would not take that fact into consideration."

To the $784,689.00, agreed cost of the physical properties, undepreciated, at present prices, he added $555,995.00 to cover overheads and going value, making $1,340,684.00 his estimate of the cost to rebuild the plant new as if there were no plant. The Company had set up no regular depreciation reserve (Exhibit 16, p. 131). To arrive at the present value, he estimated the amount of accrued depreciation to be $163,670.00, which, deducted from the estimated cost of reproduction, left

$1,177,314.00, and this he deposed was the value for rate-making purposes. A summary of Mr. Hamilton's valuation is shown on page 1 of his report (Exhibit 13) and follows:

Item Summary	Unit Reproduction Cost New	Total Present Value
Real Estate	$ 20,000	$ 20,000
Buildings and Structures	92,818	83,536
Power Plant Equipment	326,872	253,815
Distribution System	323,113	270,484
General Office Equipment	15,327	13,028
Utility Equipment	6,559	4,919
Contractor's Expense and Profit	92,850	75,979
Omissions and Contingencies	41,783	34,191
Total	$ 919,322	$ 755,952
Engineering and Supervision	43,872	43,872
Organization and Legal Expenses	28,896	28,896
Taxes during Construction	7,224	7,224
Interest during Construction	39,973	39,973
Working Capital	35,695	35,695
Materials and Supplies	33,770	33,770
	$1,108,752	$ 945,382
Going-Concern Value	231,932	231,932
Total	$1,340.684	$1,177,314

The first six items in column one constitute the physical property and, added, make $784,689.00, the agreed cost thereof, new, at present prices. This shows the way he apportioned the agreed value to the property.

On page 129 of Hamilton's report (Exhibit 13), is shown how he arrived at the amount added for overheads. The $92,850.00 for "Contractor's Expense and Profit" is 12½% of the value he assigned to "Buildings and Structures," "Power Plant Equipment" and "Distribution System." The $41,783.00 for "Omissions and Contingencies" is 5% of the

value he assigned to "Buildings and Strutrues," "Power Plant Equipment," "Distribution System," and "Contractors Expense and Profit." The $43,872.00 for "Engineering and Supervision" is 5% of the value he assigned to "Buildings and Structures," "Power Plant Equipment," "Distribution System," "Contractor's Expense and Profit" and "Omissions and Contingencies." The $28,896.00 for "Organization and Legal Expense" is 3% of the value he assigned to "Buildings and Structures," "Power Plant Equipment," "Distribution System," "Contractor's Expense and Profit," "Omissions and Contingencies," "Engineering and Supervision," "Real Estate," "General Office Equipment" and "Utility Equipment." The $7,224.00 for "Taxes during Construction" is 3/4 of 1% of the value he assigned to "Buildings and Structures," "Power Plant Equipment," "Distribution System," "Contractor's Expense and Profit," "Omissions and Contingencies," "Engineering and Supervision," "Real Estate," "General Office Equipment," "Utility Equipment," and "Organization and Legal Exxpense." The $39,973.00 for "Interest during Construction" is 4% of the value he assigned to "Buildings and Structures," "Power Plant Equipment," "Distribution System," "Contractor's Expense and Profit," "Omissions and Contingencies," "Engineering and Supervision," "Real Estate," "General Office Equipment," "Utility Equipment," "Organization and Legal Expense" and "Taxes during Construction." The $35,695.00 for "Working Capital" is 1/6 of the average of a year's cost of operation and maintenance. The $33,770.00 is for "Materials and Supplies."

This summary is not in accord with the figures given on Mr. Hamilton's oral examination. On pages 129 and 130 of the printed reord, "Administration and Legal Expenses" are placed at $16,676.00, instead of $28,896.00, "Omissions and Contingencies" at $36,140.00, instead of $41,783.00; "Taxes during Construction" at $6,670.00, instead of $7,224.00; "Interest during Construtcion" at $27,445.00, instead of $39,973.00; "Engineering and Supervision" at $37,947.00, instead

of $43,872.00; "Working Capital" at $34,772.00, instead of $35,695.00; "Materials and Supplies" at $32,697.00, instead of $33,770.00, and "Going Value" at $187,016.00, instead of $231,-932.00. In his oral evidence he also deposed to an item of $45,530.00 for "Development Expense" (Record, p. 130.)

Mr. Henry Exall Elrod, the engineer representing the City, submitted two reports, or studies. In one he reported the actual cost of the properties as reflected by the books and records of the Company as of January 1, 1920, undepreciated, to be $819,555.09. To this he added $33,980.00 estimated for working capital, making the book value of the plant $853,-535.09. From this $343,868.40 was deducted for his estimate of accrued depreciation, leaving $509,666.69, which he rounded out to $510,000.00 and recommended as the value for rate-making purposes. His detailed report of this study is Exhibit No. 16, omitted from the printed record.

Mr. Elrod's other report, or study, in which was included an inventory of the property, was also omitted from the printed record and is here as Exhibit No. 17-a. The differences between his two studies are explained on pages 134-5 of the printed record. On page 1 of Exhibit 17-a he states the method used as follows:

> "The inventory of the properties of the Brush Electric Company of Galveston, Texas, as set out on the following pages, represents in detail all of the properties of the Company, now in use and useful in the service of the public of Galveston. The items and quantities have been ascertained by an actual physical count and measurement and have been carefully checked.
>
> "The appraisement of the value of the various items is made upon the basis of the cost of reproducing same, at prices of labor, material and equipment prevailing prior to the War and unaffected by abnormal war prices, where such items were purchased and installed prior to the war. Such items as were purchased and installed subsequent

to the War are appraised at their actual cost, as reflected by the Company's records.

"In every instance, covering items purchased and installed prior to the war, where the Company's records did not reflect the actual cost of the items in questoin, prices averaged over a ten-year period, prior to 1916, were used; in many instances, where the Company's records were clear on the cost of items, higher prices than those reflected by the records, were arbitrarily used, in order to secure average rather than actual cost."

This inventory and appraisal was prepared by Mr. Elrod before the engineers made the above agreement, but, as is shown on pages 184-5 of the printed record, it was made to conform to the agreement in so far as it fixed the cost of the physical property, at averaged pre-war prices, at $576.898.00. To this agreed value Mr. Elrod added $28,609.00 for engineering, $57,218.00 for contractor's expense and profit, $33,980.00 for working capital, $11,404.00 for organization and $11,444.00 for interest during construction, making the total cost of reproduction of the property $719,553.00. On this basis of value he estimated the amount of accrued depreciation at $292,441.00, which, deducted, made the present value by this method, for rate-making purposes, $427,112.00.

There was, therefore, before the Master, after allowance for depreciation, three valuations, namely: Mr. Hamilton's hypothetical cost of reproduction at present prices, viz: $1,177,-314.00; Mr. Elrod's report of the book cost, in round numbers, $510,000.00; and Mr. Elrod's hypothetical cost of reproduction at pre-American war prices, viz: $427,112.00.

The Master, for reasons set forth in his report, fixed the value at $800,000.00. He started with the amount of the cost of the bare physical properties, undepreciated, at present prices as agreed to by the engineers, to-wit: $784,689.00. From this figure he took real estate, $20,000.00; office and utility equipment, $15,757.00, and then deducted 28% for

accrued depreciation, giving $534,818.00, which he found to be the depreciated value of the depreciable items. To this he added for overheads and restored the items deducted, his figures being:

Depreciated value of depreciable items	$534,818.00
Contractor's expense and profit 10%	53,481.00
Engineering and supervision 5%	26,740.00
Omissions and contingencies 2%	10,696.00
Organization and legal expense	11,404.00
Working capital	35,695.00
Interest during construction	11,444.00
Materials and supplies	33,770.00
Going value	46,195.00
Real estate	20,000.00
Office and utility equipment	15,757.00
Total	$800,000.00

Exceptions were filed by both parties to the Master's report. Although the trial court treated the Master's findings only as advisory, he nevertheless ruled the exceptions (Record, p. 293). For reasons stated in the opinion, he assumed the base value the Master had used, although disapproving it. After disallowing certain items included by the Master, he fixed the fair value at $612,000.00 (Record, p. 299).

But Judge Hutcheson made errors in calculations when effect is given to his opinion. As we construe the opinion, he intened to value the property by taking:

Agreed value of physical property, undepreciated, at present prices		$784,689.00
Less non-depreciables:		
Real Estate (present value)	$20,000.00	
Office Equipment	15,327.00	
Utility Equipment	6,559.00	$ 41,886.00
Undepreciated value of depreciable property		$742,803.00

Add for

Contractor's expense and engineering supervision, 10%		74,280.00
Organization, legal expense, interest and taxes during construction, omissions and contingenices		37,140.00
		$851,223.00
Less accrued depreciation 33 1/3%		284,741.00
		$569,482.00
Add non-depreciables		41,886.00
		$611,368.00
Working capital	$35,695.00	
Material and supplies	33,750.00	69,445.00
Value for rate-making purposes		680,813.00

Judge Hutcheson's value, in round numbers $612,000.00, would be correct but for the fact that he failed to add the $69,445.00 that he allowed for working capital and material and supplies. But it should be borne in mind that he used this valuation, as explained in the opinion, even though higher than he thought it should be, because he could do so and still the Ordinance would not be confiscatory.

The Master found 8% as a fair rate of return. which Judge Hutcheson approved.

* * * *

The Master, in determining the amount of net earnings available for a return, used as a test period the year ended July 31, 1920. While the District Judge had the operating experiences before him for the calendar year 1920, which showed an increase, still in deciding the case he used the period adopted by the Master.

The Ordinance of 1919 under attack, because of an injunction, was not put into effect. The inferences as to what

revenue it would have produced were based upon the operations of the year ended July 31, 1920, under the Ordinance of 1918, which fixed higher rates. This Ordinance, the Master found, produced more than a fair return, but he found that the 1919 one would have produced less than a fair return had it been in effect. The Master found the gross revenue under the 1918 Ordinance to be $333,079.65 and estimated that the Ordinance of 1919 would have produced $55,810.24 less, or $277,267.39. According to Appellant's claims (adopted by the Master with reservations), the operating expenses, including maintenance, for the twelve months ended July 31, 1920, were $228,621.73, which included items aggregating $31,789.99 the City urged should not be considered in determining the amount of estimated earnings that would be produced by the Ordinance of 1919 if in effect, and also urged that the $47,534.29 allowed for maintenance should be reduced. The District Judge sustained these exceptions to the extent of eliminating from operating expenses items aggregating $20,924.00 and reduced maintenance to $25,000.00.

The Master allowed 4½% for an annual depreciation reserve on the total valuation of $800,000.00 which he assigned to the property for rate-making purposes and which, it will be noted, included overheads, real estate, working capital and material and supplies. The District Judge sustained the City's contentions that only 4% should be allowed and ruled that this should be made to apply only to the depreciable property. The result reached by the Court was:

Operating income—1919 Ordinance (estimated)		$277,000.00
Operating expenses ($181,187.44 Company's books) less $20,924.00 disallowed by me	$160,163.00	
Maintenance allowed by me	25,000.00	
For annual depreciation	21,000.00	$206,163.00
Available for a return		$ 70,837.00

which is over 8% on the Master's value of $800,000.00, over 10%

on the Judge's value of $680,813.00 as corrected above, and is over 8% on the value of $825,230.00 Appellant claims in its brief on pages 88-9. Under the several propositions urged by Appellant we will consider in detail the action of the trial court in reducing operating expenses by $20,924.00, in reducing maintenance to $25,000.00, and in allowing $21,000.00 for a depreciation reserve. If the court was correct in these particulars, the value claimed by the Company could be adopted and still the Ordinance is not confiscatory.

Judge Hutcheson dissolved the injunction and dismissed the bill for two reasons:

(a) Because the net revenue available for a return under the Ordinance, if in effect, would have been over 8% on his tentative valuation of the property; and

(b) There had been no trial or test of the Ordinance.

* * * * *

Before considering Appellant's propositions, we call attention to that part of the argument under the first and other propositions, where it is suggested that some of defendant's exceptions to the Master's report are insufficient. Some are rather general (Record, p. 55), but are believed to be sufficient. The Master was appointed only in an advisory capacity. The case was not decided alone on the evidence before the Master, but was heard in part by the Judge, who considered all of the evidence and, as he says, made his "own findings on the evidence, with a view of determining whether the Ordinance of 1919 would be confiscatory even upon the basis of the earnings which complainant does not prove but estimates it would produce." Since the case was decided in these circumstances, are not the Master's report and the exceptions thereto immaterial? However, in Knoxville vs. Knoxville Water Co., 212 U. S. 1, 53 L. Ed. 371, it is said:

> "In view of the character of the judicial power invoked in such cases it is not tolerable that its exercise should rest securely upon the findings of a master, even though they be

confirmed by the trial court. The power is best safeguarded against abuse by preserving to this court complete freedom in dealing with the facts of each case. Nothing less than this is demanded by the respect due from the judicial to the legislative authority. It must not be understood that the findings of a master, confirmed by the trial court, are without weight, or that they will not, as a practical question, sometimes be regarded as conclusive. All that is intended to be said is, that in cases of this character, this court will not fetter its discretion or judgment by any artificial rules as to the weight of the master's findings, however useful and well settled these rules may be in ordinary litigation."

FIRST PROPOSITION.

The Court was not bound to adopt as the value of the properties, undepreciated, the agreed cost thereof at inflated war prices.

It seems to us sufficient answer to Appellant's first proposition, to which the foregoing is counter, to say that although the trial court did not approve the valuation by the Master based on inflated war prices, for the purpose of deciding the case, he did in fact adopt it with some modification of the estimates for overheads. He found net earnings available under the 1919 Ordinance more than sufficient even at this high valuation to pay an 8% return and therefore decided that it was unnecessary to determine whether a lower valuation should be made. To have done so would have been to decide an academic question. The Court says in his opinion (Record, p. 294):

> "I shall not substitute a value of my own, for the reason that in view of the fact that the injunction will be denied on the ground that the ordinance has had no test, and that in my view taking the Master's base the ordinance is still not confiscatory, it will not be necessary for me to hazard a guess as to what value should be taken."

While it is true that this Court has in a number of decisions, without suggesting or approving any particular method, looked with favor on the claim that the value of the property should be

determined as of the time when the inquiry is made regarding rates, still this has not been construed as requiring a valuation on the cost-of-reproduction method based on unit prices abnormally high since the war. Indeed, the very opposite was held in the recent case of Galveston Electric Co. vs. City of Galveston, decided April 10, 1922. There the engineers agreed upon the cost of reproduction on the basis of unit prices in effect at the time of the construction of the component elements of the property. At the time this valuation was made prices "had risen to 110% above those of 1913." The Electric Co. sought to have 60% to 70% of this increase capitalized; the Master and trial court allowed 33-1/3%, and this Court approved their decisions. That was a companion case to the one at bar and decided by the trial judge at the same time. The lower courts and commissions have taken much the same view in considering war prices for rate-making purposes. See note in 20 Am. Law Reports, Annotated, 555-589, where the opinions of the lower courts and commissions are collected and reviewed. The valuation Appellant seeks to have adopted was at practically the highest war prices. To adopt such a valuation, arrived at by the cost-of-reproduction method, would be to disregard the record cost, and Mr. Elrod's estimate on the basis of the cost of reproduction at unit prices that prevailed during the ten years prior to January 1, 1917, which were substantially higher than 1913 prices. If the property was to be valued by applying unit prices to an inventory, transitory inflated prices occasioned by the war can not be used.

Surely the agreement between the engineers did not, as is suggested by Appellant on page 23 of its brief and elsewhere, "put up to the trial court and to this Court on appeal one question, and only one question, with respect to the value of the 'bare bones'." The agreement was only to show that the engineers were in accord as to the cost of the physical property at averaged pre-war prices and at the time the agreement was made. There was no intention either to attempt to bind the Court to adopt one or the other of the agreed values or to adopt the cost-of-reproduction method in arriving at the value. On the other hand, the engineer representing the City recommended that the

value should be that shown by the books and records. This was a higher value than the "prudent investment," as that term is used by Mr. Justice Brandeis in the Galveston Electric case. (See Exhibit 16, p. 1, and Summary of Exhibit 17-a, p. 185, printed record.)

While the agreement between the engineers does not say so on its face, the evidence shows that the values agreed to are the result of applying unit prices to the respective inventory each one made of the property, which is but another way of saying that the cost of reproducing the physical property, new, as of January 1, 1920, at present prices was $784,689.00, and at the averaged pre-war prices was $576,898.00. The inventory for the Company is in Exhibit No. 13 and for the City in Exhibit No. 17-a.

To adopt the cost-of-reproduction method as the sole and only evidence of fair value for rate-making purposes would be to run counter to several decisions by this Court. "The cost-of-reproduction method is of service in ascertaining the present value of a plant when it is reasonably applied," said Mr. Justice Hughes in Minnesota rate case, 230 U. S. 352. Can it be said that the method is reasonably applied when it is supposed that the plant is reproduced during a period of temporarily inflated prices when it is hardly possible that such a plant would be rebuilt? In Potomac Electric Power Co. vs. Public Utility Commission, P. U. R. 1920 C, p. 341, it is said:

> "Reproduction cost less depreciation is but one of the elements of value, and in my judgment ordinarily only a negative element, to be considered in the final determination of fair value. Its use is to throw light upon the actual amount invested, and this can only be done where the reproduction cost is determined as of a fairly normal period. It would lose all value if made as of an abnormal period when prices were abnormally low or high. To be of any assistance or real use, it must be made as of a normal time and the unit cost applied thereto should extend over a sufficient number of years to show a normal trend of prices. To quote

the language of former Justice Charles E. Hughes, acting as referee in the case of Brooklyn Borough Gas Co. vs. Public Service Commission, P. U. R. 1918 F. 335, 347, (July 24, 1918)":

In this opinion Judge Hughes said:

> "While it is important to consider the cost of reproduction in determining the fair value of a plant for rate-making purposes, it cannot be said that there is a constitutional right to have the rates of a public service corporation based upon the estimated cost of the reproduction of its property at a particular time regardless of circumstances. To base rates upon a plant valuation simply representing a hypothetical cost of reproduction at a time of abnormally high prices due to exceptional conditions would be manifestly unfair to the public, and likewise to base rates upon an estimated cost of reproduction far lower than the actual bonafide and prudent investment because of abnormally low prices would be unfair to the company."

In Galveston Electric case, the valuation adopted by the trial court, it is true, was arrived at by appreciating by one-third the cost of reproduction on the historical basis; but neither side urged the record or book cost, because it was admitted that the book values were some $400,000 more than the cost of reproduction on the historical basis, due to the fact that property which disappeared through wear, obsolescence, etc., was not charged out (Record p. 110 in Galveston Electric case); and so it is in the case at bar, the record or book value Mr. Elrod found to be $819,555.00, is $242,657.00 more than the agreed cost of reproduction at averaged pre-war prices of the physical property. If, say, 15% for overheads (the amount agreed on in the Galveston Electric case) is added, the record or book value would still be $156,123.00 more than the cost of reproduction, new, at averaged pre-war prices. This difference is, no doubt, due to the fact that neither the Galveston Electric Co. nor Appellant set up a depreciation reserve to which items worn out or otherwise disappearing were charged. If this had been done, the book values would, no doubt, be nearer to the cost of reproduction on the historical basis. In these circumstances, we submit that book

values, in so far as they reflect the value of the physical property, should be ignored, just as the engineers in the Galveston Electric Co. case in effect agreed to do. We think this is the sound view, although Mr. Elrod, for the City, recommended in the instant case that record or book values be adopted, his final value for rate purposes on this basis including overheads, being $510,000.00 as against $427,000.00, including overheads, on the historical reproduction basis at averaged pre-war prices.

No doubt, if Judge Hutcheson had been put to the necessity of valuing the property, he would, in line with the decision in the Galveston Electric case, have started with the cost of reproduction at averaged pre-war prices as the base and made additions thereto for overheads and working capital in the amounts made necessary by the evidence.

There is, however, a further distinction between the agreed historical cost of reproduction at pre-war prices, as that term is used in the agreement between the engineers in the Galveston Electric case and the instant case. In the former they had in mind unit prices that prevailed prior to 1914; while in the instant case the evidence shows the engineers had in mind, in making the agreement as to the cost of reproduction at averaged pre-war prices, the ten years prior to January 1, 1917, which period included some 2½ years of the war, during which there had been a substantial increase in prices. Therefore, if the principle that was applied in the Galveston Electric case is adopted, the 33-1/3% appreciation that was allowed would not be applicable here. The agreed "present prices" were only 36.4% more than the averaged pre-American war prices. There was evidence to the effect that prices had in fact increased some 110% above the normal level in 1914. In respect to this the Master said:

> "It was agreed by the parties that upon pre-war prices there had been a general average advance in cost of the various factors making up the property of 110%. It will be observed that the effect of these figures is to add to the pre-war valuation of $576,898.00, 36.4%, which makes the undepreciated value of $784,689.00 on January 1, 1920, which will hereafter be referred to as present value; or

in other words, the prewar value as above stated is 73.6% of the present value."

Had the trial court started with the pre-war valuation of $576,898.00, the result would have been:

Agreed values of physical property undepreciated		$576,898.00
Less non-depreciables—		
Real Sstate	$20,000.00	
Office equipment	15,327.00	
Utility equipment	6,559.00	$ 41,886.00
Value of property undepreciated		$535,012.00
Add for overheads 15%		79,631.00
		$614,643.00
Less accrued depreciation 33 1/3%		204,881.00
		$409,762.00
Add non-depreciables		41,886.00
		$451,648.00
Working capital	$35,695.00	
Material and supplies	33,750.00	69,445.00
Value for rate-making purposes		$521,093.00

If inflated war prices are now adopted, they will return to plague those who advocate them. Even at this time of receding prices, it is interesting to note early valuation decisions where the cities wanted the value at cost of reproduction, such as that by Mr. Justice Brewer in 1894 in National Waterworks Co. vs. Kansas City, 62 Fed. 865, where it is stated on p. 866:

"There is a large amount of testimony as to the probable cost of reproducing the system, to which strenuous objection is made on the ground of an alleged temporary and extreme depression in the cost of labor and material."

Now, almost 30 years later, we find the positions reversed, but the inconsistencies mutual. When labor and material have gone back to pre-war levels, no doubt the utilities will be asking for the cost of the investments that have been made during the years of high unit prices and the courts urging the reproduction theory in order to escape construction costs incurred during and since the war.

* * * *

We will consider together the second proposition, where it is urged that accrued depreciation should have been fixed at $407,984.84, being 28% of the value of the depreciable items undepreciated, and the tenth proposition, where it is urged that the Court should have fixed the annual depreciation allowance at $40,605.51, being 4½% of the cost of reproduction value of the physical property, undepreciated, plus contractor's expense and profit, engineering and supervision, omissions and contingencies, and interest during construction.

PROPOSITION COUNTER TO SECOND AND TENTH.

The Court, on the proofs, properly deducted for accrued depreciation 33 1/3 per cent of the value of the physical property new and allowed for annual depreciation 4 per cent on the value of the depreciable property.

Mr. Hamilton, the engineer for the Company, determined the amount of accrued depreciation by the "inspection method," which he described as follows:

> "In arriving at that I don't take up each item of material and find when it was put in and the time it has been in service and calculate it—that is not the way I arrive at it. I get at it in this way: At the time my men made a detailed inventory of this property they made an inventory of the property and determined from that inspection and from the history of its life which they had, and from the efficiency which our operating report shows it still had." (Record, p. 127).

The engineer for the City used the "straight line method," which he has described in detail on page 38 et seq. of Exhibit No. 16.

In Appellant's brief, errors made by the City's engineer in applying the "straight line method" are forcefully pointed out. It is believed, however, that they are the sum total of those shown by the record, or that could have been shown. They are not large in the aggregate. Errors were also made by the engineer for the Company in applying the "inspection method." In deducting for accrued depreciation on a smokestack 5 ft. in diameter on the inside and 125 ft. high, Mr. Hamilton, for the Company, assigned it a value of $10,400.00, which is 90% of his estimate of the cost of its reproduction new. The stack was between 33 and 38 years old (printed record, pp. 151-2). This estimate of accrued depreciation was made during the latter part of 1919 by a Mr. Cropper of New York, who did not testify. (Record, p. 224). At that time there were three bands on the stack, put there some five years before because a crack had developed near the top. At the time of the hearing before the Master, it was admitted by Mr. Phipps, the general manager, that it was dangerous and that it was advisable to take it down (Record, p. 224). Mr. Elrod deposed that it was a liability rather than an asset, because it would cost more to remove it than the material in it was worth (Record, p. 152).

The "inspection method" of arriving at accrued depreciation is, no doubt, of service when it is reasonably applied. How reasonably it may be done in any given case must necessarily depend on the ability, carefulness and fairness of the parties who are employed to make the estimates. This is a highly important factor which must always be kept in mind. Under the "inspection method" different engineers, even when doing the work carefully and fairly, would no doubt be wide apart. The evidence in the case at bar warrants the conclusion that the parties who made the estimates of accrued depreciation for the Company were not careful and fair. The trial judge in judicial language, but with a pointed meaning, said:

"It is plain that the Master took neither the actual depreciation as testified to by Hamilton, nor the theoretical depreciation on the basis testified to by Elrod. I shall do likewise. I concur with the Master in declining to follow the estimates of Mr. Hamilton on this point, for the reason that both in that and other matters his testimony in matters of opinion shows such a partisan bias as to justify its characterization, in the language of the supreme court, as 'that most unsatisfactory evidence, the testimony of expert witnesses employed by the parties.' Being deprived of accuracy, and remitted to estimates, I shall take as my depreciation allowance 33-1/3%." (Record, p. 294).

It is believed that the evidence made necessary this action of the trial court. It will be noted that Mr. Hamilton, for the Company, based on the report of his men, from his estimate of the cost of reproduction of the property, new, deducted for accrued depreciation only $163,670.00, which is 18.9% of the total property values less real estate, but including contractor's expense and profit and omissions and contingencies. He asked for an annual depreciation allowance of $44,966.00, which is 5% of $899,322.00, being the value he assigned to the depreciable property (Record, p. 109). This amount is 27.4% of his total estimated, accrued depreciation. If this amount ($44,966.00) was necessary to replace items of value worn out during the year 1920, then for the same reason property values at the same rate disappeared during the preceding year, and so on down to the beginning of the business. But property values for the preceding year were less than the year 1919, on which he was making his estimate, on account of the fact that during the year 1920 $44,966.00 worth of same disappeared through depreciation. Therefore, the values for the preceding year were $899,322.00, less the accrued depreciation for the year, $44,966.00, or $854,356.00. But during the preceding year new values were added to the properties in the actual sum of $9,118.00 (Record, p. 152), so that total values of the property as a basis for estimates of depreciation were $863,474.00. We make the following tabulation to illustrate and for convenience:

Year	Value July 1st	Additions	Value June 30th	Depreciation 5%
1920	$899,322	.....	.....	$44,966
1919	854,356	$ 9,118	$863,474	43,174
1918	820,303	5,077	825,380	41,269
1917	784,111	15,165	799,276	39,963
				.....
	Total			$169,372

Thus it will be seen that over a period of only four years the accrued depreciation amounts to the sum of $169,372.00, or $5,702.00 more than the total estimated amount of accrued depreciation allowed by Mr. Hamilton to cover the previous life of the properties extending over more than fourteen years. In other words, accrued depreciation was practically a negligible factor compared to the amount claimed for annual current depreciation.

It is fairly deducible from the evidence, excepting real estate, buildings and brick smokestack, acquired about thirty-five years ago, that most of the additions to the property were made since 1905. (Record, table between pages 152-3, Column 2). 42.27% of the total values was added during the years 1906 to 1910, inclusive. Actual additions were made as follows:

1906	$ 27,282	1913	$ 40,039
1907	116,126	1914	13,609
1908	26,977	1915	22,133
1909	62,384	1916	15,977
1910	66,165	1917	15,165
1911	26,119	1918	5,077
1912	45,472	1919	9,118
			$4911,365

According to Mr. Hamilton's estimates, the main portion of the buildings, the real estate and the brick stack constitute 10.7% of the total property values, including contractor's expense and

profit and omissions and contingencies. Therefore, the additions made since 1905 must constitute 89.3% of the total value of the physical properties. Therefore

12.26 per cent of the properties are 1 to 5 years old,
34.77 per cent of the properties are 6 to 10 years old,
42.27 per cent of the properties are 11 to 14 years old,
10.70 per cent of the properties are more than 35 years old.

100.00 per cent.

The amount of Mr. Hamilton's allowance for accrued depreciation covers less than four years of the life of the property, estimated at 5% per annum, and at 4% it will be less than five years. As shown above, 42.27% of the property values are 11 to 14 years old, and 10.7% are more than 35 years old (this last item includes real estate). Thus it will be seen that Mr. Hamilton's allowance for accrued depreciation to be deducted from the agreed cost of reproduction value, new, we submit, is inadequate by more than 50% (42.27% and 10.7% equal 52.97%).

Mr. Elrod used as the basis of his estimates of depreciation the recorded ages of the various elements of the property and applied rates of depreciation which are supposed to work out by the law of averages with a reasonable degree of accuracy. We submit this is a more logical and reasonable method than that of inspection. No one individual has ever lived long enough nor had varied experience enough to be able to go into a plant such as that in question, with all of its diversified items of equipment, and by inspection and efficiency reports estimate with any reasonable degree of acuracy the conditions of age, wear, rot, rust, obsolescence and adequacy of such equipment. While neither method may be perfect, it is believed that in most instances the method used by Mr. Elrod is the more trustworthy.

Mr. Hamilton's evidence in respect to the amount that should be allowed for annual depreciation was in part as follows:

"The climate at Galveston and its effect upon the equipment, property and plant of the plaintiff does not affect the rate of return, but it does have an effect upon the amount of depreciation that must be allowed on the property. The average rate of depreciation in this property must be much higher than on an inland property, and other average properties, because of the fact of the effect of the salt air upon the steel and copper. I am not talking now about depreciation from the value of the property for the purpose of obtaining a rate basis, but about the average annual allowance that must be maintained to keep it up. I have calculated, and we are claiming in this case, the ordinary five per cent for that allowance and I have not put in an excessive claim for that. I mean five per cent on the physical property exclusive of the real estate. The plaintiff is now rebuilding a steel stack at the present time. The average steel stack will average a life in Galveston of five or six years, while if it was in Kansas City it would have a life of fifteen or sixteen years. I mean any inland town. I just took Kansas City as being away from the effect of the salt air." (Record, p. 128).

The substance of Mr. Elrod's evidence was, that while there may be component elements of such a plant that have longer lives than 25 years, taken by and large, the experience of the best authorities indicates that 25 years is the composite life of a utility such as this, and he therefore fixed the rate for annual depreciation at 4%.

4% was the amount allowed in the Galveston Electric case. The Master in the instant case divided the difference, allowing 4½%, but it is clear that even if he adopted the right rate he misapplied it. He made it to apply to the total value of $800,000.00 that he placed on the plant. It is too clear for argument that the amounts allowed for working capital, material and supplies, real estate, and most of the overheads do not depreciate. Real estate generally appreciates. Even Mr. Hamilton, upon his valuation of the properties for rate-making purposes at $1,177,314.00, only sought to have the allowance for annual depreciation at 5% to apply to $899,322.00. It is clear, therefore, that the Master

did not fully comprehend the nature and purpose of the allowance for annual depreciation. The trial court, as in the Galveston Electric case, fixed the rate at 4% and made it to apply only to the depreciable property, with the result that he estimated in his final setup that $21,000.00 was adequate. This conclusion is well within the evidence.

While there is in Appellant's brief, as well as in the record, much criticism, and some of it perhaps meritorious, of Mr. Elrod's theory of arriving at the amount to be allowed for annual depreciation as well as of the values to which the rate should be applied, on the other hand there is practically no evidence to warrant the 5% rate except the opinion of Mr. Hamilton. In so far as making application of the 4% rate, it would seem enough to say that Judge Hutcheson did as was done in the Galveston Electric case, which decision has been approved, although in the brief for the Galveston Electric Co. a vigorous and able attack was levelled at the Court's action. (See page 58 et seq. of Appellant's brief in Galveston Electric case).

* * * * *

For convenience and in the interest of brevity, we group and answer Appellant's 3rd, 4th, 5th, 6th and 7th propositions, in which it is urged that the Court should have allowed on the depreciated value of the depreciable property included in the agreed valuation, for contractor's expense and profit 10%, or $53,481.00; for engineering and supervision 5%, or $26,740.00; for omissions and contingencies 2%, or $10,696.00; for interest during construction 4%, or $21,392.00; and for taxes during construction $5,348.00.

PROPOSITION COUNTER TO APPELLANT'S THIRD, FOURTH, FIFTH, SIXTH AND SEVENTH.

Even if the property should be valued solely upon the reproduction basis, the allowance of 10 per cent, being $66,900.00, for contractor's expense and engineering and supervision and 5 per cent , being $33,450.00, for organization, legal

expense, interest and taxes during construction, and omissions and contingencies was, under the evidence, adequate.

Appellant of necessity urges the foregoing propositions upon the assumption that the property will be valued upon the cost-of-reproduction method at war prices. The Master adopted the cost-of-reproduction theory of valuation and allowed for these items in the amounts stated in Appellant's propositions, except that he allowed nothing for taxes during construction and $11,444.00 for interest during construction instead of Appellant's claim for $21,392.00.

Mr. Elrod, the City's engineer, testified that when the reproduction method of valuation was used it was proper to take these overheads into consideration, but did not admit that any such allowances should be made. The basis in the record for these claims is found in the testimony of Mr. F. C. Hamilton, the engineer for Appellant, who said:

> "The percentages fixed by me are only arbitrary in the sense that they are made on the experiences on properties that have been built and purchased and sold and promoted, and of which I had an accurate knowledge." (Record, p. 226).

It will be noted by referring to the summary of Mr. Hamilton's valuation shown on page 5 of this brief that he has, in effect, pyramided his estimates for these various items in such a way that he claims for "omissions and contingencies" 5.464% instead of 5% of the agreed cost of reproduction of the physical property, new, and for "engineering and supervision" 5.737% instead of 5%, for "organization and legal expense 3.682% instead of 3%, for "taxes during construction" .921% instead of .75%, for "interest during construction" 5.094% instead of 5%, and an additional lump sum for "going value" of 29.557%. His total overheads aggregate, including going value, 62.597% of the cost of reproduction, new, of the physical properties. This percentage figure, however, includes contractor's expense and profit, which he puts at 12½%. These estimates are made, it should

be borne in mind, upon the impossible assumption that the plant is entirely blotted out and is being rebuilt. This is to imagine the inconceivable. To allow estimates of this character upon this impossible assumption would result in forcing the public to pay out large sums of money yearly to cover imaginary expenses which never have been and never will be incurred. Yearly charges of real money should not be imposed on the public, based on such imaginary suppositions. These estimates are what some of the courts and commissions have called "sky-rocketing speculation." The Montana Commission, in Helena L. & R. Co., 1920 D, P. U. R. 668-688, has well said:

> "This practice is pursued by reputable engineers in like cases. But the method is not worthy of emulation. We deplore the all too evident tendency in public utility valuations to discard fact bases for hypothetical postulates in the matter of overhead charges, where inquiry will reveal satisfactory evidence of such charges. Too many times reality is deliberately disregarded for sky-rocketing speculation. Any theory of reproduction cost must begin with production cost; otherwise it is the merest guesswork. The actual cost records of the company are ordinarily the very best evidence of what overhead charges should be, and, in every instance, must be given full and controlling weight. Only the absence of such records should permit of percentage estimates in gross. Wholesale estimates ought to be the last resort of necessity arising from utter lack of original evidence. In our consideration of overhead values we bear in mind that we are dealing with three assembled and established plants in more or less successful operation."

Mr. Hamilton, who made these estimates, said:

> "I made no examination to ascertain whether the books in fact disclosed any charges upon which to base my estimate on the overhead, and I would not have paid any attention to them if they had. The books had absolutely nothing to do with it whatever." (Record, p. 226).

In the case of Galveston Electric Co. vs. City of Galveston, it will be noted that Mr. Elrod, who is the engineer for the City in the instant case, also represented the City in that case; and he

and the eminent engineer and author, Mr. H. P. Gillette of Chicago, who represented the Electric Co., agreed upon the undepreciated cost of reproduction of the properties on the historical basis, which "estimate of $1,720,000.00 includes a total of $202,000.00 of overhead charges to cover the following items: Engineering and Superintendence, Law Expenses, Interest during Construction, Injuries and Damages to Construction Work, General Expense and Organization Costs, but exclusive of Bond Discount and Brokerage Fee." The engineers agreed upon the overheads as a percentage of the basic valuation exclusive of the land, the $202,000.00 being 14%. (See Record, p. 106, in that case). In Des Moines Gas Co. vs. City of Des Moines, 238 U. S. 153, the overheads allowed were 15%. Judge Hutcheson in the instant case allowed 15%. The evidence offered in support of these wholesale estimates is that of Mr. F. C. Hamilton, which, we submit, should not be followed in view of Judge Hutcheson's conclusion that "his testimony in matters of opinion shows such a partisan bias as to justify its characterization, in the language of the supreme court, as "that most unsatisfactory evidence, the testimony of expert witnesses employed by the parties." Obviously it is so.

EIGHTH PROPOSITION.

No separate and distince allowance should have been made for "going value."

The evidence upon which it is sought to have a separate and distinct allowance made for "going value" is, in the main, that given by Mr. F. C. Hamilton. He testified:

> "This item in amount $187,016.00, I have determined as the value attaching to the business (because of its being a going concern with an established income) over and above the value of the physical items. I have determined this amount by the Alvord method. This method is based on a determination of the cost of reproduction of an identical plant and of the sacrifice of income which an investor would make providing he was to construct an identical plant and have the possession of the income postponed until the end of that construction period, instead of entering into the possession

of an existing plant with its established revenues. I have determined this value exactly as any purchaser of an established business determines the additional amount that he can afford to pay over and above the value of the physical property which he must buy, to secure an already established business, the only exception being that there is included in this determination no costs for meeting competition such as would be included in the case of an individual buying a dry goods store or some other business where he would have to meet competition." (Record, pp. 131-2).

In Exhibit 13, page 1, where a summary of Mr. Hamilton's figures is shown, he attributes to this item $231,932.00. In Mr. Hamilton's oral evidence (Printed Record, p. 130), he speaks of having added $45,530.00 for "development expense." Mr. Elrod, engineer for the City, applied the so-called Wisconsin method of determining "going value" and found that the compounded surpluses exceeded the compounded deficits by $470,025.55 (Table in printed record between pages 152 and 153). Referring to this table, Mr. Elrod testified:

"Column No. 14 is made up of the surpluses and deficits compounded, at the rate of eight per cent annually, to and including 1919, from the dates of the occurrences of such deficit or surplus, and the sum of the compounded deficits and the compounded surpluses is $470,025.55 in favor of the compounded surpluses. The actual surpluses exceed the actual deficits by $528,117.51. There were fifteen years when deficits are shown and sixteen years in which the Company made money in the thirty-one years of operation since 1890. In the sixteen years that they made money they made $528,117.51 more than they lost in the fifteen years that they did not make money. The loss of $20,000 in 1918 has been variously explained as being attributable to the war and to other conditions. They say that during a part of that period there were fully eight hundred houses vacant in Galveston.

"Going value has been considered in making my estimates, and I have estimated going value as being the deficits or fair return, which includes all items of expenses

for which the Company did not get an adequate return. It is reasonable to suppose that the cost of overheads contributed to the early losses. These early losses were later recouped by earnings over and above a fair return. In fact, the total surpluses, that is total amounts earned over and above a fair return on the value of their property each year, has been greater by $528,000.00 than the total deficits. In 1915 there is $111,394 earnings put down there. There was one year back as high as $85,000, and it run on down $72,000.00, $68,000.00, $65,000.00 and $61,000.00 in 1916. Those figures are correct, but I don't remember having made an analysis. I can not explain why it appears that the earnings in 1915 were so large and afterward run all the way down from $85,000.00 to a loss in other years." (Record, pp. 157-8.)

A further explanation is made by Mr. Elrod in an affidavit on page 242 of the printed record.

In the Galveston Electric case the claim to a separate allowance for "going value" was upon a state of facts somewhat different from the instant case. In that case, by applying the so-called Wisconsin formula to different periods of the Company's operations, the deficits exceeded the surpluses in amounts ranging from $2,000,000.00 down to $212,450.00, and it was sought to capitalize, at least in part, these deficits as going value. The property had been valued on the basis of cost of reproduction, with 14% added for overheads. It was ruled that there could not be erected out of these past deficits a legal basis for allowing an additional amount on the theory that such deficits constitute "going value." The instant case is like that except that 15% for overheads was allowed by the trial judge instead of 14%, and when the Wisconsin formula is applied a large surplus instead of a deficit is shown. It is true that in the Galveston Electric case the engineers in their agreement as to values did not use the word "bare bones," but the evidence shows they did what was done in the instant case: they inventoried the property and agreed on the cost of its reproduction at unit prices. The term "bare bone" might well have been used in the agreement in that

case if they had not succeeded in agreeing on the amount to be added for overheads.

But Appellant claims a separate allowance for a different reason and calculates it under an entirely different formula known as the Alvord method. As we understand it, this formula is applied by assuming that this long-established utility was not in existence in the year 1920. It is then assumed that this identical plant is reconstructed out of a fund sufficient to cover the cost of reproduction of the "bare bones," with say 15% added for overheads. It is then assumed that the investors therein would not earn a fair return from the time it is constructed and ready for business and this additional amount is sought to compensate for the sacrifice of such fair return until a paying basis is reached.

What is meant is, that if a new plant were built, tuned up and ready for business it would not be as valuable as the one now inexistence, because this one is no longer an experiment, but is actually earning a fair reutrn and more on the investment, and it is assumed that the new one would have to make a financial sacrifice before becoming profitable. It may be that some utilities have in the past made such sacrifices, but if they did it was their own fault, because they had the right from the very beginning to insist on a fair return. Mr. Justice Brandies made this clear in the Calveston Electric Co. case, when he said:

> "A company which has failed to secure from year to year sufficient earnings to keep the investment unimpaired and to pay a fair return, whether its failure was the result if imprudence in engaging in the enterprise, or of errors in management, or of **omission to exact proper prices for its output,** can not erect out of past deficits a legal basis for holding confiscatory for the future rates which would, on the basis of present reproduction value, otherwise be compensatory.(Knoxville vs. Knoxville Water Co., 212 U. S. 1, 14, 53 L. Ed. 371, 380, 29 Sup. Ct. Rep. 148." (Bold face ours.)

After constructing the imaginary plant, Appellant assumes that deficits will occur, and in advance seeks to capitalize them when it has the right from the beginning to exact proper prices for its output. And if it does not, it can not afterwards capitalize them. If deficits can not be capitalized after they have occurred, by what process of reasoning can it be said that they should be capitalized before they have been incurred?

Judge Hutcheson in his opinion in Galveston Electric Co. vs. Galveston, 272 Fed. 147, 160, went to the heart of the question when he said:

> "In any case, where a plant is fully valued upon the cost of reproduction basis, the allowance of any element for development cost can not, in a judicial proceeding, be reasonably sustained for the reason that **such a utility is entitled to a reasonable rate of return upon its plant from the day it goes into operation,** and the court does not take into consideration at all that there may be lean years before the fat ones. Therefore, a court in a rate case has nothing to do with any increment to the actual value of the plant acquired by the successful operation of it, nor in a case of valuation, where the cost of the plant and its historical development is determined, does the court add anything to its capitalization for rate-making purposes for its unsuccessful years, nor deduct anything for its successful ones." (Bold face ours.)

In the instant case the plant was not valued as junk, but as a going concern. There were added to the "bare bones" cost of reproduction the very overheads necessary to put it in successful operation and make it a going concern. In other words, as was said by Mr. Justice Day in Des Moines Gas Co. vs. Des Moines, 238 U. S. 153:

> "When, as here, a long established and successful plant of this character is valued for rate-making purposes, and the value of the property is fixed as the Master certifies upon the basis of a plant in successful operation, and

overhead charges have been allowed for the items and in the sums already stated, it can not be said, in view of the facts in this case, that the element of going value has not been given the consideration it deserves, and the appellant's contention in this behalf not sustained."

It may be that there is a speculative increment of value in a plant that has become a profitable enterprise because of public use, but this is not a value to be capitalized for rate-making purposes and especially should this be true where more than a fair return has been exacted in the past. While not on this specific question, the following from Mr. Justice Hughes' opinion in the Minnesota rate case has application:

"And where the inquiry is as to the fair value of the property, in order to determine the reasonableness of the return allowed by the rate-making power, it is not admissible to attribute to the property owned by the carriers **a speculative increment** of value over the amount invested in it and beyond the value of similar property **owned by others, solely by reason** of the fact that it is used in the public service. That would be to disregard the essential conditions of the public use, and to make the public use destructive of the public right.

"The increase sought for 'railway value' in these cases is an increment over all outlays of the carrier and over the values of similar land in the vicinity. It is an increment which can not be referred to any known criterion, but must rest on a mere expression of judgment which finds no proper test or standard in the transactions of the business world. It is an increment which, in the last analysis, must rest on an estimate of the value of the railroad use as compared with other business uses; it involves an appreciation of the returns from rates (when rates themselves are in dispute) and a sweeping generalization embracing substantially all the activities of the community. For an allowance of this character there is no warrant."

Judge Hutcheson, after considering the foregoing and other portions of the opinion in the Minnesota rate case, concluded:

"I think it clear, therefore, that if the court, as a basis for inhibiting legislative action, should add to the property a purely speculative increment of going concern upon the view that the public, by using the property, has increased its value, it would be doing what the Supreme Court has forbidden; that is, it would disregard the essential conditions of the public use, and 'make the public use destructive of the public right.' In short, when 'going concern' is stripped of its involvement and obscurity, its attractive names and titles, it presents itself on the one hand where the past record of the utility has been profitable, as nothing more than good will, which the courts have always refused to allow, and, on the other hand, where the past record has been unprofitable, as nothing more than an effort to capitalize errors and misfortunes, as to the impropriety of which the decisions of the Supreme Court are equally clear.

"The confusion which has resulted in this matter is that which springs from the failure to distinguish the essential principle involved in these rate controversies, that a utility is entitled to earn on its property a fair return, and that the rate can neither be increased, on the one hand, by the fact that the company has enjoyed a profitable business, nor decreased, on the other hand, by the fact that its business has been unprofitable, either because of the lack of support of the utility by the people of the community, or of any other untoward features which would gravely affect the company, if its property were valued for the purpose of bargain and sale." (272 Fed. 147, 161.)

The Master says he came to the conclusion that the "going value" was about $50,000.00, but allowed therefor $46,195.00 so as to make his valuation the even sum of $800,000.00 (Record, p. 52). No reason is given why or how he arrived at this amount. No doubt he did what Mr. Gerard C. Henderson said in his article on "Railway Valuation and the Courts," 33 Harvard Law Review, 1037, that expert appraisors do in these circumstances:

"It is not surprising to find that when expert appraisers report the value of a railroad's 'good will' or of its

'strategic location' or the value arising from the fact that it is a 'going concern,' they are never able to indicate the rational process by which the result is reached. They almost always resort to a general and inarticulate exercise of judgment."

The Alvord method has been frequentlly condemned because the result reached is by pyramiding assumptions. Being convinced that no separaate allowance for going value will be made, we forego consideration of methods.

ELEVENTH PROPOSITION.

The ordinance of 1919 was not confiscatory within the meaning of the Federal Constitution if it could be reasonably anticipated that it would allow a return of approximately 8 per cent on the fair value of the property.

The engineer for the City deposed that 8% was a fair rate of return, and used this rate in his calculations. Mr. Hamilton, for the Company, thought the rate should be 10%. His evidence is on pages 127, 128 and 245 of the printed record. The outstanding bonds, in the sum of $1,265,000.00, bear 5% interest (Record, p. 36). In the Galveston Electric Co., 8% was adopted by the Master and the Court and by both Master and Court in the instant case.

Art. 1018 of the Texas Revised Statutes has no application, because (a) it applies only to cities and towns incorporated under the general laws; and (b) Appellant has not sought to have its return fixed under the statute "on the actual cost of the physical properties, equipment and betterments," but upon a hypothetical cost of reproduction. In Appellant's brief only a portion of the statute is quoted. It reads as follows:

> "The city council of all cities and towns in the state of Texas of over two thousand population, incorporated under the general laws thereof, shall have the power to regulate, by ordinance, the rates and compensation to be charged by

all water, gas, light and sewer companies, corporations or persons using the streets and public grounds of said city or town, and engaged in furnishing water, gas, light or sewerage service to the public, and also to prescribe rules and regulations under which such commodities shall be furnished, and service rendered, and to fix penalties to enforce such charges, rules and regulations; provided, that the city council or board of aldermen shall not prescribe any rate or compensation that will yield less than ten per cent per annum net on the actual cost of the physical properties, equipment and betterments."

Galveston is not incorporated under the general law, but by special charter (Record, p. 132). It is an error, therefore, in Appellant's brief where it is stated that Art. 1018 applies.

Neither does Art. 1028 apply for the same reasons that Art. 1018 does not apply. Art. 1028 is a part of Chap. 13, Title 22, of the Texas Statutes, vesting jurisdiction in the state District Courts to determine rates and by Art. 1026 applies only to cities and towns incorporated under the general laws. Art. 1028 follows:

"Upon the trial of the cause, it shall be the duty of the court or jury, in arriving at a decision as to whether or not the rates complained of are reasonable or extortionate, and in fixing the rates, to consider the cost of construction of the plant of the public utility corporation against which the petition is filed, the cost of the operation of such plant, its maintenance and repairs, the fixed charges that may be against the corporation, amount invested in such plant, and such other matters as may be material to the issues. And the court trying the same shall have the power to order the corporation to make profert of its books and records for inspection in court for its information in determining the question in issue. After a full hearing of all the evidence adduced by the parties, the court or jury shall have power, and it shall be their duty to fix the rates which may be charged by such public utility corporation; provided, that the rates fixed must be sufficient to yield such public utility company not less than ten per cent upon the investment, and the same shall continue in force for a period of three years. The rates fixed

shall be entered of record upon the minutes of the court, and shall be held conclusive, as reasonable, fair and just, and shall remain for three years as the rates to be charged by such corporation, unless changed or modified by the judg- of said district court, or by the appellate courts to which either of the parties to said suit may appeal, or have writ of error."

The purpose of the statutes quoted was to prevent the smaller towns and cities, where in the nature of things the investment in utilities is more hazardous, from allowing anything less than a most liberal return. For obvious reasons these statutes do not apply to the larger cities chartered by special acts.

Moreover, it is believed that Federal Equity Courts are not bound by a rate of return fixed by a state statute.

TWELFTH AND FOURTEENTH PROPOSITIONS.

In determining the amount of net earnings that would be produced by the 1919 ordinance, the trial court properly allowed not more than $5000.00 to cover traveling, storm and fire expense.

There was an item of $2330.00 for traveling in the expense account for the year used as a test period by the Master. During the storm of 1915 the property was damaged and the amount of the loss charged to operations and amortized (Record, p. 176) and $2,220.21 included in operating expenses during the year used as a test. During 1919, a loss of $13,247.99, not covered by insurance, was sustained and amortized (Record, p. 176) and $6,379.99 charged to operations for the year used as a test period. The Master took the full amount of these items into account in estimating the amount the Ordinance would produce; the trial court allowed $5,000.00 therefor. Mr. Elrod deposed that the storm expense was a proper charge to depreciation rather than to operations (Record, p. 176).

Without some explanation, it is believed that $2,330.00 is an abnormal amount for traveling. This is almost $200.00 per month. No necessity therefor suggests itself. The burden of proof is on Appellant.

It is not reasonable to suppose that another fire or storm will occur. These are such unusual and extraordinary occurrences that they should not be taken into account in estimating normal net earnings.

On page 106 of Appellant's brief, reference is made to records of the Weather Bureau (not in the record), said to show the number of storms and hurricanes that have visited Galveston. These records are erroneous. Under the circumstances, it seems to us not amiss to refer to a stipulation shown in the printed record, page 97, in the Galveston Electric case.

Following the one disastrous hurricane of 1900, when approximately 6000 people lost their lives and many millions of property damage was done, a seawall was built and the grade raised. Since then there has been but one storm of any magnitude, which was in 1915, but on account of these protective measures there was little property damage and practically no loss of life, although this storm lasted considerably longer than the one in 1900. (See Encyclopedia Brittanica). In view of these protective measures, there is small possibility of future damage.

Moreover, it is believed that losses resulting from such casualties are to be borne by the utility as one of the hazards of the business. If such losses are to be underwritten by the public, the rate of return should be less than 8%. Mr. Gerard C. Henderson, in the article "Railway Valuation and the Courts," 33 Harvard Law Review, 902 and 1031, cited by Mr. Justice Brandeis in Galveston Electric case, well said:

> "If you are to assume the risk of earthquakes, floods, and strikes, or of unavoidable mistakes in construction or operation, you will insist, and rightly insist, on a larger percentage

return to compensate you for that risk. If we assume those risks, we are entitled to ask you to be content with a lower rate of return. If you are to get the benefit of what my friend calls the unearned increment, that is an added attraction which the community is offering you, and which should induce you to accept a very moderate rate of annual return; if you are to get a return only on the money actually invested, you will be reasonable in demanding a larger rate of return."

The trial judge allowed $5000.00 for these three items in forecasting normal expenses.

THIRTEENTH PROPOSITION.

The Trial Court properly declined to take into account, in estimating earnings under the 1919 ordinance, the loss of $14,024.27 sustained during the year 1919 in the new busines department.

In 1915, the Company established a merchandising department for the sale of electrical merchandise, in which losses were sustained as follows:

1915	$15,566.57
1916	12,476.92
1917	10,009.84
1918	10,476.48
1919	9,637.30
Total.....	$58,167.11 (Record, p. 161).

During the test period the Master found that this department lost $14,024.27, but during the calendar year 1920, as stated in Appellant's brief, it earned a substantial profit. Evidently, as the court found, it is established and on a paying basis. In these circumstances, the trial court was within the evidence, if not bound, to consider that this would not in the future be a source of loss.

FIFTEENTH PROPOSITION.

In estimating the probable net revenue under the 1919 ordinance, the trial court properly allowed for maintenance not more than $25,000.00.

The record shows, as Judge Hutcheson points out in his opinion, that for the six years preceding the filing of this suit the average cost of maintenance was about $13,000.00. Judge Hutcheson applied the rule approved by Mr. Justice Brandeis in the Galveston Electric case when he said:

> "The proper annual charge for maintenance is the amount normally required for that purpose during the period; it is not necessarily the amount actually expended within the year."

The Master allowed $47,534.29 for maintenance, the amount actually expended, which was almost 15% of the gross income. The trial court was overly generous in his forecast of the amount that would be normally required. This point is fully and aptly covered by his opinion.

SIXTEENTH PROPOSITION.

The trial court properly held that the sum of $750.56 for condemned meters and $75.03 for condemned transformers should have been charged to depreciation reserve and not to operations.

It would seem too clear for argument that these items should not have been charged to operations but to the depreciation reserve.

* * * * *

We respectfully submit for the reasons stated that the trial court was warranted in the following conclusions:

"We arrive at the following set up by taking the estimated income under the 1919 Ordinance stated by the Master and deducting from the operating expenses allowed by the Master the items disallowed by me, we have—

Operating income—1919 Ordinance (Estimated)		$277,000
Operating Expenses ($181,087.44 company's books, less $20,924 disallowed by me	$160,163	
Maintenance allowed by me	25,000	
Depreciation	21,000	
Return	50,000	$256,163

showing an excess of earnings over fair return of $21,000.

"If all of the operating claims disallowed by me were restored the figures resulting would still show a sufficient return.

"In these operating figures taxes are included, with no separation between ad valorem and income taxes. If income taxes are deducted, a further excess return will of course appear.

"The figures of operating expenses and return for the six months ending July (December) 31, 1920, make an even better showing, for the company.

"In the testimony before me, as well as before the Master and in the argument before me, it was made evident that this company is now operating under a favorable oil contract of long standing, which will shortly expire, and that the price of oil has enormously increased.

"As to this and all similar matters which will either reduce or increase costs in the future, it can not be assumed by this court that a rate-making body, charged with the function, will not, upon proper showing, give speedy and reasonable relief.

"Let a decree be entered dissolving the temporary restraining order heretofore granted, refusing the injunction prayed for, and at the option of the complainant, either dis-

missing its bill without prejudice, or passing same to the suspense docket, with leave to again call the matter up after a trial of the ordinance, or before trial, should unusual and extraordinary conditions occur, making it imperative to save complainant's property from confiscation." (Record, p. 299).

Even without a deduction for income taxes and after allowing $5,555.00, or 8% on the item of $69,445.00, for working capital and material and supplies that Judge Hutcheson failed to add when he fixed the value at $612,000.00, there is still an excess of earnings over a fair return of $15,445.00.

The injunction should have been dissolved and the bill dismissed, because there had been no trial or test of the ordinance.

The Ordinance in question reduced rates so that the Company could not add a net surcharge of 1½ cents per kilowatt hour to light bills, 1¼ cents per kilowatt hour to power bills, 1¼ cents per kilowatt hour to wholesale rates, and 1 cent per kilowatt hour to battery charges off peak, and allowed a 10% instead of a 5% discount on lighting and power bills (Record, pp. 11-15). The Master found that the elimination of these surcharges and the change in the discount on lighting and power bills would have reduced gross revenue $55,810.20 (Record, p. 52). The City's engineer testified that the sum of $34,715.00 was produced by the surcharge in 1919 (Exhibit 16, p. 135). The District Judge said: "It is a well-known economic fact, especially applicable to lighting and power business, that a reduced rate will invariably increase its business."

When the Ordinance of 1918 was passed, increasing rates, there was a temporary reason therefor, shown by the following evidence of W. R. Phipps, General Manager of Appellant Company, who testified:

"In 1918 the net earnings dropped again,—and that was the year we applied for an increase in the rates by the addition of the surcharge. In 1918 there were hundreds of vacant

houses caused directly almost by the conditions of the war, and many people had moved away from the city. That caused a great loss in the number of our customers; and I might say in addition to that that during the first three months of 1918 we paid $1.75 for oil; that would affect the earnings too." (Record, p. 225).

Due to the conditions stated, gross earnings for the year ended June 30, 1918, were less than during any similar period since Appellant had acquired the property in 1912 (Exhibit 16, p. 36). But by July, 1919, when the Ordinance in question was passed, the war was over, shipping had resumed, and business was getting back to normal, gross income had increased and it was believed then that prices would recede rapidly. Appellant Company and Galveston Electric Co., the two companies furnishing power and lights, were both notified on July 17, 1919, by the Board of City Commissioners to appear on July 30, 1919, and show cause why the rates being charged shrould not be reduced (Record, p. 249). Appellant Company appeared through its General Manager, Mr. W. R. Phipps, who testified in respect to the hearing:

"I appeared before the Board of Commissioners for this city in July, 1919, representing the Company. I don't recall just how much detail we went into, but we filed some sort of statement with the Board; it was not a complete financial statement, however. In that statement the Company claimed the right to earn at least eight per cent on what it claimed to be the fair value of its property, $1,265,000.00; it was not placed any higher at that time. We used that figure as a matter of convenience, as we did not have any figures on the actual property."

(Record, p. 221.)

The record does not disclose the showing, if any, made by the other company, but the records of this Court do show that on May 8, 1920, it filed a suit to enjoin an ordinance passed in 1919, reducing street car fares. It did not complain of power and light rates, although the same power plant furnished electricity.

While the Board at that time may not have had accurate information as to the value of Appellant's property, it knew it was being rendered for taxes to the City for $347,900.00, and for state and county $279,420.00 (Record, p. 228).

Is the foregoing evidence not sufficient to show that the Company did not deal frankly with the Board, to say the least of it, in an endeavor to arrive at a rate fair alike to the public and to the Company? Under the Ordinance of 1918, it earned at the Master's unreasonable valuation and estimate of available net income, at least $4,457.00 more than 8% on $800,000.00 (Record, p. 54). It earned this much in excess of an 8% return, after allowing the whole expense account, $47,534.00 for maintenance, and 4½% for an annual depreciation reserve on $800,000.00, which included real estate, working capital, material and supplies, separate allowance for going value, and the Master's large estimates for overheads.

It was in order for the Board of Commissioners to make some reduction in rates, which it did. The reduction, as is shown above, was not large. It could not be told then, and can not be told now with any degree of accuracy, just how much this would have reduced the net income available for a return. The trial judge has well said that the Company did not prove, but estimated what the Ordinance would produce. A practical test was required to remove the doubt. Under the precedents, a test of the Ordinance should have been made before applying for an injunction. Willcox vs. Consolidated Gas Co., 212 U. S. 19, 63 L. Ed. 382; Knoxville vs. Knoxville Water Co., 212 U. S. 1.

But it is urged that the City has waived the right to urge this point. It did consent, when the bill was filed following Judge Batts' order, to let the injunction issue. This was fair to the Company, as it was contending so vigorously in its bill that the 1919 Ordinance would be confiscatory. It was contemplated that a speedy hearing would be had, but, as it

turned out, a long time elapsed between the filing of the bill on August 21, 1919, and the final decision on March 1, 1921. The City's action in the premises might well be commended rather than made the basis for urging that it has waived the right to urge this point. After the parties went to the expense of having the properties valued it was to the advantage of both that the controversy be passed on, so that some basis would be had in the future for fixing rates. There had been no valuation of the property for rate-making purposes prior to filing this suit (Record, p. 250).

* * * *

In justice to the members of the Board of City Commissioners who passed the Ordinance in question, some of the conclusions in Appellant's brief should be noticed, even though it is believed it has been shown by the record that they were fully warranted in passing the Ordinance. The evidence from which it is concluded that the Board was arbitrary and hasty is the following by Judge E. D. Cavin:

> "I wish to make this statement, if the Court please, upon a phase of the case that may come under consideration. The last election for members of the Board of Commisioners of the City of Galveston was held May 13, 1919. At that election all the members of the Board of Commissioners then in office were candidates for re-election and all of them were members of the Board of Commissioners that passed the rate ordinance of 1918 that has been introduced in evidence, granting certain increases in the rates for electric current as shown thereby, and they were opposed by candidates of what was known as the City Party. During the campaign preceding the election of 1919 the rate for electric current as fixed by the ordinance of 1918 was one of the campaign issues and those rates were atacked by the candidates of the City Party, one plank of whose platform was 'No raising of gas and electric rates and street car fares without the consent of the people.' The said ordinance of 1918 was adopted by the Board of Commissioners without submission to popular vote. At the election held May 13, 1919, the members

of the old Board were defeated and the City Party candidates elected, and they qualified on the 22nd day of May, 1919, and on July 31, 1919, passed the ordinance sought to be enjoined in this case. On July 18, 1919, a notice was issued by the City Secretary on the order of the Board of Commissioners to the Brush Electric Company to appear on July 30, 1919, and show cause why the rates for electric current should not be reduced, and it was in response to that notice that on July 30, 1919, W. R. Phipps, Manager of the Brush Electric Company, submitted to the Board the statement that has been introduced in evidence and is here referred to and is Page 36, Exhibit 16, Part 1."

"At this point plaintiff introduced in evidence certified copy of the notice referred to by the witness, same being as follows:

" 'Resolved, That the Board of Commissioners investigate the reasonableness of the rates charged for Electric Current by the Galveston Electric Company and Brush Electric Company, and that each of said corporations be notified by the City Secretary to appear before the Board of Commissioners at the Council Chamber in the City Hall on July 30, 1919, at 10 o'clock A. M., and show cause why the rates being charged by them for Electric Current in this City ought not to be reduced.'

"On Cross-examination the witness testified as follows:

" 'The ordinance that is in question in this case, which is the last ordinance, took effect immediately. There had been an increase in rates prior to that, in 1918. That was voted by the Board of Commissioners that were in opposition to the Commissioners that granted the last increase. At that time the increased rates were granted in 1918 they did not attempt any valuation of the properties of Brush Electric Company. I do not know in detail upon what evidence they proceeded in granting the increase of 1918. I had nothing to do with those negotiations—they were between a Committee of the Board of Commissioners, of which I was not a member, and in consultation with the management of the Company, and I think the City Electrician. They finally determined

upon this increase in 1918. I do not know whether the Company at that time submitted to the Board any statement as to the values of their properties upon which they asked that a return be granted. As a matter of fact, I was not in Galveston from about the first part of April, 1918, until November of that year. I don't know the value they claimed for the plant at the time they asked that the increase in November, 1918, be granted, but I know there had been no valuation made of the properties. The only valuation for rate-making purposes that has ever been made of the plaintiff's or its predecessor's property are those made in connection with this case. I had intended to put that in there. I also say that the rate ordinance of 1915 which has been introduced in evidence is the first ordinance ever passed by the City of Galveston undertaking to regulate or fix rates for electric current. That is, I say, after making as full an investigation as I can.'

"'Both parties rested." (Record, pp. 249, 250.)

When Judge Cavin said that he was not a member, he meant that he was not a member of the committee that carried on the negotiations at the time the 1918 Ordinance was passed. He was a member of the Board of Commissioners at that time, but away from the city. General Manager Phipp's evidence above shows why the Ordinance of 1918 was passed increasing rates. There is nothing in the record to indicate that a full hearing was had. There had been no valuation of the properties. We submit, therefore, the conclusion is not deducible that: "The ordinance of July 18, 1918, was adopted by the municipal authorities of Galveston, in response to an application of the complainant for an increase in rates, **and after a full hearing.**"

The conclusion is not warranted that: "In the election held May 13, 1919, all members of the old Board which adopted the Ordinance of 1918 increasing electric light rates, were **of course,** defeated, and the candidates of the City Party, who by their platform promised **to reduce rates were, of course, elected.**" There was no promise to **reduce** rates. The platform provided that they would not raise rates without the

consent of the people. Neither is the conclusion warranted that because of this **one** provision in the platform, and for that reason **alone,** a new Board was elected. This was only **one** of the planks of the platform. It may be that the question of raising rates should not be subject to the consent of the people; still for obvious reasons the discussion of rates charged by local utilities is sometimes productive of wholesome results. It is a matter of discussion in municipal elections in many cities and is of such concern to the people that they are at least entitled to know why rates are advanced.

The record does not show, or purport to show, what either the Company or the Commissioners did pending the issuance **of the formal notice on July 17, 1919,** and the date of the hearing on July 30th. The evidence of General Manager Phipps quoted above shows that the Company submitted at the hearing an "incomplete" statement, which is page 36 of Exhibit 16, to which we invite attention. This statement shows that the net earnings for the preceding six months available for a return and depreciation reserve was the sum of $32,739.61. Every fact and circumstance then before the Commission pointed to the fact, as has later turned out to be true, that gross earnings would continue to increase. But this statement, without allowing for an increase, promised net for the year of $65,479.22, which the Commission could reasonably and fairly conlude was ample for a depreciation reserve and to pay an 8% return on a valuation much in excess of the amount for which the property was being rendered for taxes. The Commission had the right to disregard the unwarranted valuation of $1,265,000.00, which Manager Phipps says was used as "a matter of convenience." The Company was bound to deal frankly and fairly.

The Commission was not required to notify the Companies that it intended to reduce rates. The fair conclusion is that they gave notice to appear in order that a right conclusion might be reached. They did not act in haste, because the

Ordinance was not passed until more than two months after they qualified. Did this Company meet the Board of Commissioners half way?

We submit the evidence does not warrant the following conclusion on page 8 of Appellant's brief:

> "It would appear, therefore, that the ordinance of July, 1919, was not adopted after investigation or hearing, but that it was adopted in response to a popular demand, and to carry out an ante-election pledge made by candidates for political office, in order to secure election."

Then, too, they fixed rates not alone for Appellant Company, but for the Galveston Electric Co., which was also furnishing power and light. And since it is not shown that the other company complained of the rates, the fair inference is that it regarded them as reasonable.

Moreover, when Appellant in the courts, without a test of the Ordinance, questioned the action of the Commission, the City did not oppose the order enjoining the Ordinance, but has met the issue and found justification in the established facts for its action.

It is only by adopting the wholesale estimates of a partisan witness as to the value of the plant and by allowing estimated costs of operations that may not arise and by estimating without proof what the new rates would yield that it can be said that the Ordinance is confiscatory.

Appellees pray that the judgment of the lower court be affirmed.

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Galveston, Texas, March 12, 1923.